McKESSON

2016 Annual Report

BUSINESS
CARE
CONNECTIVITY

Delivering Better Health to All

As a mission-based company, every day McKesson helps our customers improve their business health, deliver better care, and work more effectively across the healthcare ecosystem through best-in-class healthcare services and solutions. We lead the way to healthier communities and a healthier future, bringing together all stakeholders to integrate care delivery, facilitate the transition to value-based care, and lower costs for all. Guided by our core values of ICARE and ILEAD, we are creating maximum value for our customers and investors while making McKesson a great place to work for all employees.

Deliver

1/3 of *all prescription medications* in North America

68,000 employees *in* 21 countries

McKesson Ventures invested **$28 million** *in* **SEVEN** emerging healthcare companies

Repaid nearly **$1.6B** *in* long-term DEBT

Generated **$3.7B** operating cash flow

$4B *in* announced ACQUISITIONS

$1.5B *in* share REPURCHASES

$0.7B *in* internal INVESTMENTS

>99% order accuracy

MORE THAN **13,000** owned and banner ***pharmacies***

183 *year history* of serving customers

Market Leadership

- Global ***pharmaceutical*** distribution
- U.S. specialty distribution in ***oncology***
- U.S. ***medical-surgical*** distribution
- U.S. ***pharmacy management*** systems

17 ***Billion*** pharmacy transactions *processed annually*

Dear Shareholders:

McKesson celebrates its 183rd year in business this year, and while I am very proud of our long track record of growth and success, I believe our future is even brighter than our past.

Never in the history of our industry have we seen so much change, from rapid convergence and consolidation, to the implementation of new, value-based care models, to an increase in consumerism. Across every sector, healthcare is changing before our eyes, and McKesson is at the nexus of the transformation.

I'm delighted to be writing my 15th chairman's letter in which I can reflect on our accomplishments in the past fiscal year and share my perspective on why we are so well positioned for the new future of healthcare. While fiscal 2016 was a year of many successes, it also included some new challenges, which I'm proud to say we responded to quickly and decisively. Your company ended the fiscal year in excellent shape, poised for continued growth in fiscal 2017 and beyond.

A Healthy Fiscal 2016

I am pleased to report that McKesson generated revenues of approximately $190.9 billion in fiscal 2016, up 9% year over year in constant currency, and adjusted earnings per diluted share of $12.08, up 10%, again in constant currency.[1]

McKesson saw a drop in our stock price in fiscal 2016. There were a number of contributing factors to this movement, including the softening of generics price inflation, some customer losses due to acquisition activity and general weakness in stock prices across the healthcare sector. But this was balanced by a strong operating performance across the company.

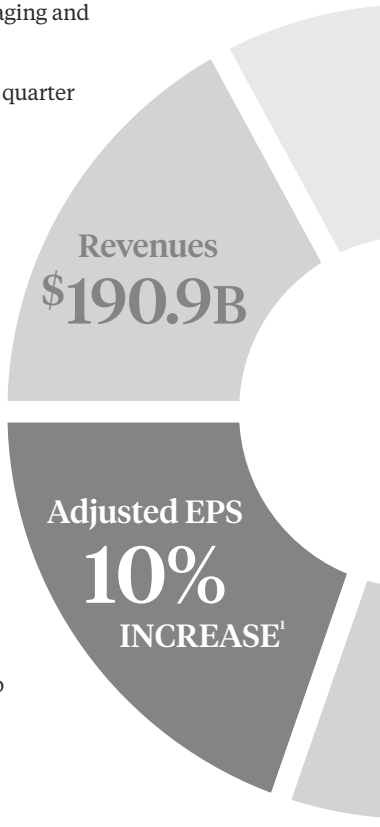
In our Distribution Solutions segment, we saw major customer wins, expanded our global pharmaceutical sourcing and procurement scale, grew the number of banner and retail pharmacies in our networks, and continued to execute on our planned Celesio acquisition synergies.

On the Technology Solutions side of the business, we saw a strong performance that reflects our focus on key growth areas, specifically revenue and payment management for payers and providers, imaging and workflow solutions, and other offerings that support the transition to value-based care models.

In response to softening generic price inflation as well as customer consolidation, in the fourth quarter of fiscal 2016, we also took steps to reduce our cost structure and improve efficiency.

In total, we generated cash from operations of $3.7 billion during the year, repaid approximately $1.6 billion in long-term debt, and ended the year with cash and cash equivalents of $4.0 billion. Further, we maintained our long-standing portfolio approach to capital deployment. The company had internal capital spending of $677 million, spent $40 million on acquisitions, repurchased approximately $1.5 billion of its common stock and paid $244 million in dividends.

As stewards of your investment, we continually balance the need to invest in the business, pay down debt, and return profits to you, our shareholders.



The Future of Better Health

McKesson helps our customers improve their business health, deliver better care, and work more effectively with other organizations across the healthcare ecosystem through an extensive suite of healthcare distribution services and technology offerings.

We believe we are extremely well positioned, especially in the businesses where we see the greatest growth opportunities, including specialty, retail pharmacy and manufacturer services. Our scale, our reputation for operational excellence and our broad value proposition allow us to build deep, long-term relationships with our customers and supplier partners.

[1]See Appendix A to this 2016 Annual Report for a reconciliation of earnings per share as reported under U.S. generally accepted accounting principles (GAAP) to adjusted earnings per share (non-GAAP). Adjusted earnings per share is a non-GAAP measure, which should be viewed in addition to, and not as an alternative for, financial results prepared in accordance with GAAP.

Expanding Scale. Two years ago, we acquired Celesio, which gave us a strong foothold in Europe and helped us drive significant global purchasing synergies. We advanced our position further in fiscal 2016 with the announced acquisition of the pharmaceutical distribution division of UDG Healthcare in Ireland and an agreement to acquire more than 200 pharmacies operated by Sainsbury's in the United Kingdom.

In the U.S., we successfully renewed a number of significant existing customer agreements while winning major new accounts. For example, we expanded our distribution agreement with Albertsons, assuming responsibility for the sourcing and distribution of generic and brand pharmaceuticals for nearly 1,700 Albertsons in-store pharmacies across the company's 33-state operating area. This five-year partnership will allow Albertsons customers to benefit from McKesson's proprietary OneStop® Generics program and the efficiency of McKesson's daily direct-to-store service model for pharmaceutical products.

Your company ended the fiscal year in excellent shape, poised for continued growth in fiscal 2017 and beyond.

Retail Pharmacy. Retail pharmacy—including independents, retail banner and corporate-owned stores—represents a key growth opportunity for McKesson. In fiscal 2016, we made significant progress in expanding our retail presence in Europe through the growth of our European Pharmacy Network. In Canada, we announced the acquisition of Rexall Health, which will significantly strengthen McKesson's position in the Canadian pharmaceutical supply chain. Through the planned acquisition of Rexall, McKesson will acquire approximately 470 retail pharmacies, with strong concentrations in two of Canada's fastest-growing regions, Ontario and Western Canada.

Health Mart®, the U.S.'s fastest-growing independent pharmacy franchise, extended its tremendous track record of growth during fiscal 2016, ending the year with more than 4,600 stores or approximately 19% growth over the prior year. The support and services offered by Health Mart help locally owned Health Mart pharmacies gain access to preferred networks, bring more patients into their stores through local marketing solutions, and offer new patient services that improve their bottom line while creating more value for their patients.

Specialty Pharmaceuticals. Specialty drugs make up roughly one-third of today's pharmaceutical spending, and are expected to drive significant ongoing growth in the pharmaceutical market. Because we see the clear opportunities for increased market leadership, we took several steps in fiscal 2016 to expand our footprint in the specialty market. We made two significant acquisitions: Vantage Oncology and Biologics. Vantage Oncology is a leading national provider of integrated oncology and radiation services, and Biologics is an oncology pharmacy services company that offers specialty pharmacy and patient support services specifically in the areas of oncology and other complex therapeutic categories. Together, these acquisitions will significantly enhance McKesson Specialty Health's services to patients, providers, payers and manufacturers.

Innovating for a Healthier Future

McKesson has a long history of innovation within healthcare, dating back to 1833 when we created the first national drug distribution system in the United States. At every step of our evolution, we have always looked for opportunities to do things better, differently, so that we can increase the value we bring to our customers.

Building the systems, infrastructure and tools that will power tomorrow's healthcare industry remains a high priority for the company. We accomplish that with both internal and external investments as well as strategic partnerships.

As a founding member of the CommonWell Health Alliance, McKesson has worked closely with industry stakeholders to help bring to life the U.S.'s first and only national network dedicated to the safe and secure exchange of patient information across all care settings. CommonWell's vision is to allow patients and caregivers to access and share their health data, which we believe will empower and engage healthcare consumers.

To date, nearly 4,400 provider sites in all 50 states, the District of Columbia and Puerto Rico have gone live with CommonWell services, and an additional 3,500 sites have committed to using CommonWell services in the future.

Last year, we also took a bold step forward in healthcare innovation by creating McKesson Ventures, our own corporate venture fund. McKesson Ventures targets companies that both catalyze and benefit from the key changes taking place in the healthcare ecosystem. The McKesson Ventures team helps its portfolio companies leverage McKesson's extensive industry knowledge and deep relationships with key stakeholders across the entire spectrum of healthcare, including payers, providers, pharmacies, manufacturers and health systems. Our collaborative relationship with our portfolio companies gives McKesson greater insight on industry trends and potential disrupters, helping inform our long-term strategy.

Investing in Tomorrow's Leaders

Speak to any of our approximately 68,000 associates worldwide and they will tell you that McKesson is a special place to work. Why? Because they know they play a critical role in ensuring that a patient in a hospital, pharmacy or doctor's office receives the treatment they need. The mission we share as a McKesson family — enabling better care and better health for patients—unifies us across the globe. We are proud that the products and services we deliver, combined with the deep partnerships we form with our business partners, make a real difference in people's lives.

To support this mission, we place a great deal of focus on recruiting the best people and helping them perform at the highest level through career development and leadership training. We aspire to have each McKesson associate feel that they will have a long and fruitful career with the company. We apply extra focus and energy to develop our high performers as we look to create a robust pipeline of future leaders. The tenure and experience of our management team ensure that we simultaneously deliver excellent results while planning for McKesson's long-term success.

Across the company, we demonstrate our commitment to better health in personal ways, as well. From the more than 10,000 employees who have achieved platinum or gold status in our wellness program to the 12,500 employees who came together in 184 locations to create comfort kits for cancer patients, better health truly starts with each of us.

Our shared ICARE (*integrity, customer-first, accountability, respect and excellence*) and ILEAD (*inspire, leverage, execute, advance and develop*) principles guide all that we do. These foundational values help advance our company across every dimension to create maximum value for our customers and make McKesson a great place to work for our associates.

Focus Ahead

I expect the pace of change in our industry will only accelerate during fiscal year 2017. Although these challenges can be daunting, they present significant opportunities for McKesson as our business partners look to us to help them navigate through the turbulence and strengthen their own competitive standing.

Ultimately, I believe there are few companies better situated for success in the global healthcare market than McKesson. Our extensive assets, global scale, market knowledge and experienced management team put us in a unique position among our industry peers. We put our shareholders' investment to work in the smartest way possible to ensure we continue to lead in the markets in which we compete. We are committed to meeting our customers' needs—today and tomorrow.

I couldn't be more excited about what the future holds—and I hope you are, too. Our company has never been more aligned with our fundamental mission: helping our customers achieve better business health in the name of better health for all.

On behalf of our entire organization, thank you for your ongoing commitment to McKesson.

John H. Hammergren
Chairman of the Board,
President and Chief Executive Officer
McKesson Corporation

Avoiding a Crisis

World Recognition of Distinguished General Counsel:
Lori Schechter, General Counsel of McKesson
Remarks by Linda Chatman Thomsen, Davis Polk & Wardwell LLP
October 6, 2016

I. Obstacles to Crisis Avoidance

A. In many instances, strict liability statutes can cause a company in crisis, or its executives, to incur liability even where a securities violation was not intentional.

1. See, e.g., Stephen Crain, Jail Time for Not Knowing: Strict Liability for Executives Under the Park Doctrine, Corporate Compliance Insights, Jul. 18, 2016 ("The Eighth Circuit just affirmed the prison sentences of two executives based on their positions of authority and little else. This is a case that should have the attention of every corporate officer. Austin 'Jack' and Peter DeCoster, executives of an egg distribution company, were sentenced to three months in prison for something their company did without their knowledge."); Ryan E. Blair & Daniel J. Teimouri, *Omnicare*: Old and New Standards for Section 11 Opinion Liability, American Bar Association (June 9, 2015).

B. A strong compliance program is a serious investment for any company, and rewards on that investment often are not immediately apparent.

1. Global advisory firm The Corporate Executive Board has noted that the median corporate compliance program budget hovers around $1.5 million per year; however, a truly effective program may cost much more and requires a commitment to compliance at all levels of the company. (Matthew Scott, The Cost of Compliance, Corporate Secretary (Mar. 10, 2014).)

2. Even if a company in crisis is determined not at fault of a securities violation, reputational damage can be extreme and result in collapse even before a determination of liability is made.

a) One recent example is Arthur Andersen LLP, Enron's auditor. Though the Supreme Court ultimately reversed Arthur Andersen's guilty verdict for destruction of documents on the basis of improper jury instructions, the firm had already collapsed. (See, Arthur Andersen LLP v. U.S., 125 S. Ct. 2129 (2005).)

C. Prosecutorial discretion and increasing pressure to aggressively pursue securities violations and corporate "bad boys" can result in unprecedented and unexpected application of the securities laws.

1. For instance, commercial fisherman John Yates was prosecuted in the Middle District of Florida using the destruction of evidence provisions of the Sarbanes-Oxley Act for throwing overboard several undersized red grouper to prevent federal authorities from confirming that he had harvested undersized fish.

2. Yates was found guilty of violating SOX – legislation designed to protect investors and resort trust in financial markets following the collapse of Enron – and appealed up to the Supreme Court. The Court found that the relevant provisions of SOX applied only to objects used to record or preserve information and, accordingly, Yates was not guilty of violations of SOX. (Yates v. United States, 135 S. Ct. 1074 (2015), Oral Arg. Tr., Nov. 5, 2014.)

II. Strategies for Crisis Avoidance – What Can Companies Do?

B. Keeping the corporate mission at the forefront of every decision made and action undertaken helps to advance the appropriate goals. At McKesson, that goal is "to advance the health care system for better health for all" following the ICARE shared principles. (See, e.g., McKesson Values.)

A. In addition, by setting a "tone at the top" that compliance is front of mind, employees will understand that prioritizing compliance is important to advancement within the company.

1. Setting a tone at the top is not just the responsibility of corporate officers but also that of any employee with managerial duties, including with respect to employee reviews and evaluations and determining employee compensation and advancement. (See Assoc. of Fraud Examiners, Tone at the Top: How Management Can Prevent Fraud in the Workplace.)

B. When an effective compliance program is in place, process and procedure becomes substance. Implementing compliance and due diligence checklists and documentation procedures – hallmarks of an effective compliance program – will result in better compliance.

2. In other fields, including the medical profession, implementation of procedural checklists resulted in improved performance and patient care. (See, e.g., Brigette Hales, Marius Terblanche, Robert Fowler & William Sibbald, Development of Medical Checklists for Improved Quality of Patient Care, 20 Int'l J. for Quality Healthcare 22 (2007); Joseph T. Hallinan, "Once Seen as Risky, One Group of Doctors Changes Its Ways," Wall Street Journal (June 21, 2005).)

C. An effective compliance program is key to ensuring that whistleblowers raise potential issues internally for review and, where appropriate, remediation, before going to the government.

1. In most instances of public whistleblowing, the whistleblower felt that their concerns were disregarded by their employer. (See The Age of the Whistleblower, The Economist, Dec. 5, 2015.)

III. Benefits of an Effective Compliance Program to Companies in Crisis

A. As mentioned above, an effective compliance program can often head off a crisis by ensuring that whistleblowers report internally first, allowing a company to remediate any issues uncovered and consider self-disclosure to the appropriate regulator.

B. An effective compliance program can mitigate corporate liability when a crisis occurs.

1. In many instances, companies with a strong compliance program will receive credit for their compliance efforts in connection with any regulatory settlement, including instances in which a rogue employee is disciplined in their individual capacity but a violation against the company is not pursued because of its strong compliance program.

a) For instance, in the DOJ's investigations of Garth Peterson, a former managing director at Morgan Stanley, it charged Peterson but declined to pursue Morgan Stanley, noting: "After considering all the available facts and circumstances, including that Morgan Stanley constructed and maintained a system of internal controls, which provided reasonable assurances that its employees were not bribing government officials, the Department of Justice declined to bring any enforcement action against Morgan Stanley related to Peterson's conduct. The company voluntarily disclosed this matter and has cooperated throughout the department's investigation." (DOJ Press Release: Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA (Apr. 25, 2012).)

(1) Peterson individually faced a maximum penalty of 5 years in prison and a fine of up to $250,000. He was ultimately sentenced to 9 months in prison and ordered to pay $241,589. (See Christie Smythe & Tiffany Kary, Ex-Morgan Stanley Executive Gets Nine Months in China Case, Bloomberg (Aug. 17, 2012).)

2. Similarly, where a company self-discloses a violation or demonstrates extraordinary cooperation in the courts of a regulatory investigation, it will often receive credit for doing so in any settlement, either through the use of a deferred or non-prosecution agreement or a culpability score reduction. (See, e.g., United States v. Barclays PLC, No. 3:15-cr-00077-SRU, Plea Agreement (D. Conn. May 19, 2015) ("The parties further agree that the Recommended Sentence is sufficient, but not greater than necessary to comply with the purposes set forth in 18 U.S.C. §§ 3553(a), 3572(a), in considering, among other factors, the substantial improvements to the defendant's compliance and remediation program to prevent recurrence of the charged offense.").)

C. Taking responsibility for a corporate misstep can also help protect corporate executives from being charged with a securities violation.

1. Recently, the SEC affirmatively decided not to bring clawback actions under Section 304(a) of SOX against Monsanto and Marrone Bio executives who reimbursed their companies for compensation received following misstated financials.

a) SEC Press Release: Monsanto Paying $80 Million Penalty for Accounting Violations (Feb. 9, 2016): "The SEC's investigation found no personal misconduct by Monsanto CEO Hugh Grant and former CFO Carl Casale, who reimbursed the company $3,165,852 and $728,843, respectively, for cash bonuses and certain stock awards they received during the period when the company committed accounting violations. Therefore, it wasn't necessary for the SEC to pursue a clawback action under Section 304 of the Sarbanes-Oxley Act."

b) SEC Press Release: SEC Charges Biopesticide Company and Former Executive with Accounting Fraud (Feb. 17, 2016): "As required by Section 304(a) of the Sarbanes-Oxley Act, Marrone Bio CEO Pamela G. Marrone has reimbursed the company $15,234 and former CFO Donald J. Glidewell will reimburse the company $11,789 for incentive-based compensation they received following the filing of Marrone Bio's misstated financial statements. They weren't charged with any misconduct."

2. Assistant Attorney General Leslie R. Caldwell has explained that: "[T]he more open you are with us about the facts you learned about [culpable] conduct during your investigation, the more credit you will receive for cooperation. . . . Put simply, cooperation – and the quality and timeliness of that cooperation – matter. . . . But if a company chooses not to cooperate, or it cooperates too little and too late, those choices also have consequences." Assistant Att'y Gen. Leslie R. Caldwell Speaks at Am.

Conf. Inst. 31st Int'l Conf. on the Foreign Corrupt Practices Act (Nov. 19, 2014).

3. On the other hand, Assistant Attorney General Caldwell also stated in the context of a $772 million penalty handed down in conjunction with a company's failure to cooperate with a DOJ's investigation that the company was "paying a historic price for its criminal conduct – and for its efforts to insulate culpable corporate employees and other corporate entities." Remarks for Assistant Att'y Gen. Leslie R. Caldwell Press Conference Regarding Alstom Bribery Plea (Dec. 22, 2014); See also United States v. Alstom S.A., No 3:14-CR-246-JBA (D. Conn. 2014).

IN THE SUPREME COURT OF THE UNITED STATES

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JOHN L. YATES, :

Petitioner :

v. : No. 13-7451.

UNITED STATES. :

- - - - - - - - - - - - - - - - - - - x

Washington, D.C.

Wednesday, November 5, 2014

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:04 a.m.

APPEARANCES:

JOHN L. BADALAMENTI, ESQ., Assistant Federal Defender, Tampa, Fla.; on behalf of Petitioner.

ROMAN MARTINEZ, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of Respondent.

C O N T E N T S

P R O C E E D I N G S

(10:04 a.m.)

CHIEF JUSTICE ROBERTS: We will hear argument first this morning in Case 13-7451, Yates v. United States.

Mr. Badalamenti.

ORAL ARGUMENT OF JOHN L. BADALAMENTI

ON BEHALF OF PETITIONER

MR. BADALAMENTI: Mr. Chief Justice, and may it please the Court:

The natural, sensible and contextual reading of Section 1519 is that the phrase "record document or tangible object" is confined to records, documents and devices designed to preserve information, the very matters involved in the Enron debacle. Given the expansive Federal nexus of this statute, which is the intent to influence the proper administration of any matter within the jurisdiction of the United States, it is implausible that Congress would have passed sub silentio, an all-encompassing obstruction statute buried within the altering documents provision of the Sarbanes-Oxley Act.

A strong textual indicator that Section 1519 is confined to record-related offenses is the inclusion of the unique term "makes false entry in," which

Congress only uses in record-related statutes. The canons of ejusdem generis and noscitur a sociis confirm that tangible object is related to the common thread between record and document which are information devices -- information mediums.

JUSTICE GINSBURG: Why should -- why should the expression "tangible object," which stands alone, it's not falsifying documents, why should the word "object" in 1519 be treated differently than the word "other object" in 1512 -- 1512(c)?

MR. BADALAMENTI: Justice Ginsburg, in Section 1519 -- it was passed at the same time as 1512(c) as part of the Sarbanes-Oxley Act. And as this Court held in Russello, when Congress includes different terms in different statutes passed in the same act, it is intended to mean something different.

JUSTICE GINSBURG: So you think there's a difference between "tangible object" and "other object"?

MR. BADALAMENTI: Yes, there is. The first reason is that the inclusion of "makes false entry in" indicates that the phrase "record document and tangible objects" refers to recordkeeping. Another difference is that -- a common sense standpoint -- is that records can only be maintained on tangible mediums. And it's a distinguishing factor between "record document" and

"other objects" in 1512(c). It's also limited --

JUSTICE SOTOMAYOR: But how does the Internet -- you could falsify Internet entries, or things that are in the cloud, those are intangible items.

MR. BADALAMENTI: No, those are tangible items, Your Honor, because they are stored on a hard drive somewhere. The cloud is not existing above. It's merely being housed somewhere else that's accessed through the Internet on a tangible device that's designed to preserve that very type of information.

JUSTICE KENNEDY: Suppose the typewriter were used to prepare an incriminating document. The document and the typewriter were destroyed, would that be covered?

MR. BADALAMENTI: The typewriter would not be. The piece of paper that the typewriter is inscribing on is a device that's designed to preserve information. It's simply making the information.

JUSTICE KENNEDY: I -- I understand the argument and the argument that you make has considerable force about over criminalizing, but it seems to me that the test you suggest has almost more problems with vagueness, more problems with determining what its boundaries are than the government's test.

MR. BADALAMENTI: No, the government's test renders 1512(c) wholly superfluous. 1519 -- first of all, the words "record document" and "tangible object" are definitions providing meaning to all of them. The government is saying admittedly, "record" and "document" didn't need to be there and Congress had no reason to put them there because it's everything, it's all physical evidence. A record -- a tangible object is a discrete device. It is a device that is designed to preserve the information.

JUSTICE ALITO: Well, if that's the -- if that is the case, then why is it not surplusage? Why -- what would be a tangible object designed to contain information that would not fall into the category of record or document?

MR. BADALAMENTI: An iPad, a laptop computer, a desktop computer, an iPhone. Those --

JUSTICE ALITO: Those things in themselves don't -- they have documents, they have something that could be called a document or a record stored in them.

MR. BADALAMENTI: That is --

JUSTICE ALITO: If you -- if you have an iPad that's straight from the store, has nothing -- has no information stored in that, do you think that would fall within the statute?

MR. BADALAMENTI: It would fall within the statute because what Congress was trying to intend to do -- and given the backdrop of the Enron situation where massive servers were destroyed or deleted or otherwise -- they were trying to -- to capture the devices that held information. And you cannot determine what's on the device unless you have the device, regardless of whether or not there's information on it or not.

JUSTICE ALITO: What about destroying a brand new empty filing cabinet?

MR. BADALAMENTI: That is not a device that's used to preserve information. That's a container of something. It's not specifically designed to preserve information. You could put bowling balls in a -- in a filing cabinet or otherwise. The information, the distinguishing factor, Your Honor, between a tangible object is that the information is being preserved within it, embedded within it, like a computer or otherwise. And Congress needed to use the general phrase "tangible object" for a reason, because in 2002, an iPad, an iPhone, and many other electronic devices that preserve information didn't exist, and they --

JUSTICE GINSBURG: But then the Congress could have said used -- tangible object used to preserve information, and then your case would be solid. But it

just said "tangible object."

MR. BADALAMENTI: It said "tangible object," that is true, Justice Ginsburg, that it said "tangible object." But it did so using that general phrase following two specific terms, "record" and "document," which is a classic methodology in which the legislature uses --

JUSTICE KAGAN: But could I go back to Justice Ginsburg's first question, because, my fault I'm sure, but I wasn't sure I understood your answer. Not only in 1512(c)(1), but there are, you know, I think five times in 1512 from a prior enactment this same kind of phrase is used, which is "record document and other object." And you say that we should treat that phrase as it exists many times in 1512 differently from this phrase in 1519 because of the difference between tangible object and other object. And to me, it seems like other object is, if anything, a more classic case of that canon that I can't pronounce the name of, ejusdem whatever.

(Laughter.)

JUSTICE SCALIA: Generis.

JUSTICE KAGAN: Good. That's what I count on my colleague for.

(Laughter.)

JUSTICE KAGAN: I -- I deserved that.

But to me, it seems like a more -- even a more classic case. So I guess I just don't understand why you're treating the two differently.

MR. BADALAMENTI: It is, to answer your question, they're being treated differently not simply because of the inclusion of the word "tangible," but because of the other words surrounding "tangible object," like the unique phrase "makes a false entry in," which is not included in any other obstruction of justice statute.

JUSTICE KAGAN: But just because Congress includes more verbs -- I mean, the reason Congress includes 20 verbs instead of 4 is presumably because Congress really wants to sweep in a very wide variety of conduct. And not every verb has to apply to every situation. In fact, we rather presume that they won't.

MR. BADALAMENTI: Although this Court has never held that all the verbs, you know, applied to all the nouns, it would make sense that they would apply. The only instance that the United States points out is in an amended statute. This statute was written from "Whoever" to the last word of this statute at the same time. It makes sense that they all apply. And "makes false entry in" is a phrase that can be used only to

apply to all of the nouns under our particular construction. And it's unique. It is only used by Congress in record-related statutes.

JUSTICE KAGAN: So your whole argument here really comes down to the fact that Congress put some record-related verbs in there?

MR. BADALAMENTI: It does not, Your Honor. There's additional things. We have a limited subject matter under our definition, which makes sense because you have a tremendously broad nexus to any matter within the proper administration of the United States. That's unlike traditional classic statutes. It makes sense that Congress wanted to narrow the subject matter of this particular statute when you're dealing with such a broad nexus to any Federal matter.

JUSTICE KAGAN: But I would think -- I'm sorry. I would think that that cuts against you, that the fact that this is about any matter within the jurisdiction of any agency in the United States shows that it's really not just about corporate fraud, that Congress had a broader set of things in mind. So I would think that that's -- that's quite the opposite, that everything about this statute, the "any matter," the "any record," suggests breadth.

MR. BADALAMENTI: It -- it does not, Your

Honor, because if you take the lens and you zoom it out a little bit further, if we look at Section 802 of Title VIII of the Sarbanes-Oxley Act, it's entitled "Criminal Penalties For Altering Documents." Two new criminal statutes were created: 1519, entitled "Destruction, alteration, and falsification of records;" and 1520, which is a 5-year record retention requirement on auditors. They were -- or else they get a 10-year penalty for that.

Congress was referring, passing these, 1519 and 1520 within Section 802 of Title VIII, as a tandem, as another contextual indicator that this is intended to apply to record-related matters.

JUSTICE GINSBURG: Then how do you -- how do you respond to the illustration that the government gave in its brief? That is, what sense does it make to say you can be indicted under 1519 if you destroy a letter that the victim that you have murdered has sent you, but you can't be indicted under 1519 if you destroy the murder weapon?

MR. BADALAMENTI: Congress did not intend 1519 to be applied in that situation. And as you state the question, Justice Ginsburg, it is remarkable that the government would use 1519 in a murder situation.

JUSTICE GINSBURG: But you think it could --

would -- let me back up and ask what I assume was -- you would say yes to. A letter is shredded. It's a letter from the victim to the later-turned-out-to-be murderer. That letter is shredded. Does that come under 1519?

MR. BADALAMENTI: That does, because that is record related. But the knife does not. That falls into the sweep -- that particular subject matter, because it indeed is a record, so that would be covered under 1519, but that -- not the knife. Congress didn't intend to sweep the knife into 1519, but --

JUSTICE SOTOMAYOR: Where did the -- I'm sorry.

CHIEF JUSTICE ROBERTS: What if the knife had the defendant's name on it? Is that, destroying the knife, is that altering, destroying a record?

MR. BADALAMENTI: It is not. One would not, Mr. Chief Justice, refer to an inscription of one's name as a permanent account of an event. It's just an identification. It's an identification on the knife.

CHIEF JUSTICE ROBERTS: Well, but presumably the same would be true of a lot of documents or records that are destroyed.

MR. BADALAMENTI: But in ordinary parlance, one would not consider an inscription on a knife to be it. It's evidence, but it's not a -- it's not a

document, it's not a record or otherwise, and it doesn't fall within the very limited subject matter that Congress wrote into this particular statute, which is records.

JUSTICE SOTOMAYOR: Now, what do you say about 1512(c)? Would the knife fall under that?

MR. BADALAMENTI: 1519 and '12(c), it would make more sense that the knife fall in, and here's why. It's a more classic --

JUSTICE SOTOMAYOR: Even if the knife was used in the murder, but it was destroyed before anybody was caught?

MR. BADALAMENTI: It would -- it would -- if it was destroyed with the intent to impair that object's availability in an official proceeding, which is a classic, classic obstruction statute --

JUSTICE SOTOMAYOR: So did the government mischarge here? Could they have charged your client with violating 1512(c)?

MR. BADALAMENTI: It's possible the government could have charged that particular thing, but --

JUSTICE SOTOMAYOR: I love those words, "possible."

MR. BADALAMENTI: It is possible.

(Laughter).

JUSTICE SOTOMAYOR: What would -- what would have been your defense if they did?

MR. BADALAMENTI: My defense would have been something very significant, difference between 1512(c) and 1519. 1519 only requires that --

JUSTICE SOTOMAYOR: I know you were charged with. What would have been your defense to 15 --

MR. BADALAMENTI: He didn't corruptly do it. And corruptly is wrongful, immoral, depraved or evil, not simply knowingly, which is required under 1519, which is voluntarily and intentionally done. See, "corruptly" is used in 1512(c) purposefully in that particular information because it is, perhaps, a broader class, and it is --

JUSTICE SOTOMAYOR: Destroyed and substituting fish is not a corrupt act.

MR. BADALAMENTI: It would have been my defense.

(Laughter.)

JUSTICE SOTOMAYOR: Touche.

MR. BADALAMENTI: Which was the question, Your Honor. Okay?

So what we -- what we have in 1519 -- what we have in 1519 is a remarkable situation when you're

looking at Chapter 73 in total, is that you have this incredibly broad nexus to any Federal matter within the jurisdiction of the United States. What can the matter be? As the amicus briefs point out, any of 300,000 Federal regulations that the Federal Government has placed down upon the American people.

JUSTICE BREYER: And what is your view, given what you've just said, of the best way to narrow this statute?

MR. BADALAMENTI: The best way to narrow this statute, Justice Breyer, is to interpret "tangible object" in the company it keeps, and that is a device that is designed to preserve information such that if that device is destroyed, the information contained on that device is destroyed.

JUSTICE BREYER: You still have the problem of the language of the statute covering the destruction of a document such as an EPA questionnaire that comes to the door asking about recycling, where you know that the EPA would like to have that back to help them do their official work of finding out how the program works. You, believing that that's their business, not yours, tear it up and throw it in the wastebasket.

Now, does that fall within the statute?

MR. BADALAMENTI: Well, it --

JUSTICE BREYER: It surely does within the language.

MR. BADALAMENTI: It falls within --

JUSTICE BREYER: And your effort to narrow the statute has nothing to do with that.

MR. BADALAMENTI: The narrowing is the document itself. This statute's exceedingly broad. Our --

JUSTICE BREYER: But my problem, of course, is reading the statute and taking your argument in the context that you mean it, which is we must look for a way to narrow this statute, which at first blush seems far broader than any witness-tampering statute, any obstruction of justice statute, any not lying to an FBI agent statute that I've ever seen, let alone those within Section 15. So what I'd like you to focus on is not your problem, though they're connected, but my problem.

MR. BADALAMENTI: Focusing on your problem, Justice Breyer, I would say that it is not an onerous situation for individuals to retain documents. It is not an onerous situation on the American people to -- particularly what we have on flash drives attached to a key chain that can hold thousands and thousands --

JUSTICE BREYER: Right. I see where you're

going.

MR. BADALAMENTI: -- of documents.

JUSTICE BREYER: I see where you're going. Let's follow you down that road: That you say in many situations it should not be a crime to retain a document, even though you know that the Census Bureau would like it back or perhaps the EPA.

MR. BADALAMENTI: Uh-huh.

JUSTICE BREYER: And perhaps it's nothing more than trying to find out information. But where you end up at the end of the road is that this is void for vagueness, but not for any reason you have yet told us. So what am I to do with the fact, if that is a serious problem, that it has never been argued in this case?

MR. BADALAMENTI: Well, I would accept the invitation that it would be void for vagueness, Your Honor.

JUSTICE SCALIA: Why is it vague? It's -- it's just incredibly expansive.

MR. BADALAMENTI: It -- it --

JUSTICE SCALIA: What is vague about the fact that if you destroy a questionnaire, you destroy a document with the intent of, what is it, to impede, obstruct or influence the investigation or proper administration. What's vague about it?

JUSTICE BREYER: The answer to that, if you want to pose it as a question to me --

(Laughter).

JUSTICE BREYER: -- would be that the void for vagueness, if you look at Skilling, has two branches. From Kolender v. Lawson -- Justice Ginsburg wrote it -- a penal statute defining the criminal offense, one, with sufficient definiteness that ordinary people can understand. That's what Justice Scalia has just talked about. You can understand what is prohibited.

But then there is two: In a manner that does not encourage arbitrary and discriminatory enforcement. It's that second part, that the doctrine extends the doctrine to statutes that, while they may be clear, are far too broad, well beyond what any sensible prosecutor would even want to prosecute.

MR. BADALAMENTI: Well, I agree with that.

JUSTICE BREYER: All right. Then back to the question.

MR. BADALAMENTI: The answer -- the answer would be that perhaps a way to reconcile this statute would be not only to accept our position that it relates to recordkeeping generally, but that it requires specifically, relates to business recordkeeping, where

businesses are on notice such as is he filing quarterly requirements or otherwise, that they are to do specific things. And if you look against the backdrop of the Sarbanes-Oxley Act, there is plenty of support that Congress was targeting businesses, corporations, and publicly traded companies.

JUSTICE GINSBURG: Isn't -- isn't running a fishing vessel a business?

MR. BADALAMENTI: It would be running a business, Your Honor, it would be. And a possible way to limit this particular circumstance would be to limit it to -- to businesses. It doesn't change the fact that "tangible object" doesn't mean everything.

JUSTICE GINSBURG: Can you -- can you tell me the exact consequences for your client? Because as I understand it, he was also charged under 22 -- what is it -- 2232?

MR. BADALAMENTI: Yes, Your Honor.

JUSTICE GINSBURG: And he could have gotten the same sentence?

MR. BADALAMENTI: No. No, Your Honor. 2232 is destroying a piece of property subject to seizure. That's a 5-year statutory maximum. 1519 has a 20-year statutory maximum.

JUSTICE GINSBURG: But he in fact got what?

30 days.

MR. BADALAMENTI: 30 -- he ended up getting 30 days by a judge that made that individualized decision under the Booker factors. But we can't count on judges being like those -- that judge around the United States. The fact remains is that --

JUSTICE GINSBURG: But you're only arguing for your client. This is not some kind of class action.

MR. BADALAMENTI: No, Your Honor, this is just related to Mr. Yates. But the idea is that -- my understanding is that when the courts are writing the opinions, they're thinking about all the judges in the United States and providing guidance to all the judges, providing guidance to the prosecutors when to use particular statutes.

And if this Court permits that this statute be applied for the disposal of all physical evidence that would contravene the textual and contextual terms and indicators that I brought through throughout this argument, it is basically the overreaching broad thing that Congress has never passed, despite the government's attempt to inject in the Model Penal Code into this case, which 1519 looks nothing like the Model Penal Code.

JUSTICE KENNEDY: Suppose the fisherman took

pictures of the fish, and then he destroyed both the pictures and the fish. Liability?

MR. BADALAMENTI: A picture? Although Congress didn't intend this in this circumstance, and we would hope the prosecutor wouldn't prosecute for this, it is a permanent account of an event that is preserving the information as to what the pictures -- what the fish looked like. So the fish thrown overboard indeed would be a record and would be covered under this statute. But it wouldn't be a tangible object because it's not a device designed to preserve the information.

JUSTICE KENNEDY: The photograph isn't?

MR. BADALAMENTI: The photo -- I'm sorry, the photograph is not a tangible object under our definition. If it were a digital camera and it's stored on a memory card on it, that would be a tangible object.

JUSTICE KENNEDY: Is a piece of paper a physical object?

MR. BADALAMENTI: A piece of paper is a piece of paper, a physical object.

JUSTICE KENNEDY: Is it an object?

MR. BADALAMENTI: It's an object as well.

JUSTICE KENNEDY: But why isn't a film if it's on it -- I'm talking not about a film on one of these screens, but an old-time film that you can pick

up. A picture, a picture.

MR. BADALAMENTI: Well, they -- it is -- the film itself is a record. The film itself is a record. It's not --

JUSTICE KENNEDY: Would its destruction be a violation of this Act?

MR. BADALAMENTI: Yes, it would be.

JUSTICE KENNEDY: It seems very odd that you can throw away the fish without violating the Act, but you can't throw away the picture.

MR. BADALAMENTI: Although it's not what Congress intended, it's what requires that this statute read even under our interpretation, which brings up the absurdity of this particular case. This underscores everything about this case that's absurd, is that the prosecutor used this statute in this way. And had he thrown a piece of paper overboard that had the day's catch logs on it, that would have been covered, and we concede that that would have been covered.

JUSTICE SOTOMAYOR: Well, then why is that absurd? If you concede that that would have been covered, the catch logs, and the prosecutor is trying to do the exact same thing, it's just that he's thrown over a different piece of evidence, why is that such a crazy outcome?

MR. BADALAMENTI: The -- the absurdity aspect comes down to the -- perhaps the prosecution in this case, and I didn't mean to overstate that, Justice Kagan. The fact is, is that throwing it overboard, the log, the picture that memorializes what that fish looked like at the time is a record, and it would fall within it.

And taking a step back to Justice Breyer's question earlier --

JUSTICE SCALIA: Wouldn't it be just as absurd to give him 20 years, though, wouldn't it?

MR. BADALAMENTI: It would be extremely absurd, Justice Scalia.

JUSTICE SCALIA: Yes. I don't understand.

JUSTICE KAGAN: But that clearly falls within the statute. I mean, you can't argue that it doesn't. So --

MR. BADALAMENTI: The only -- the only way we could argue --

JUSTICE KAGAN: You know, it seems as though this is -- Congress gives very strict penalties to lots of minor things, and -- but that's, you know, that's what it does.

MR. BADALAMENTI: Congress did something that was very, very strong language to the American

people in the Sarbanes-Oxley Act. It added 1519 to cover record-related matters, 20 years. 1512(c) is related to official proceedings -- we've discussed that earlier -- 20 years. It upped wire fraud, mail fraud, from 5 years all the way up to 20 years. Why did Congress do that? It did that because it recognized the harm that Enron/Arthur Andersen type of situations did to the financial well-being of this country and the investors in public markets, and it wanted to send a message to the public to not engage in record destruction that could impede or influence the proper administration of any matter. That's why it's important to limit the subject matter of this particular statute to just record-related matters.

If there are no more questions, I would like to reserve the remainder of my time for rebuttal, Mr. Chief.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

Mr. Martinez.

ORAL ARGUMENT OF ROMAN MARTINEZ

ON BEHALF OF THE RESPONDENT

MR. MARTINEZ: Mr. Chief Justice, and may it please the Court:

Section 1519's key phrase, "any record, document, or tangible object," unambiguously encompasses

all types of physical evidence. That's clear from the standard meaning of those words in ordinary speech and from the broader statutory and historical context in which those words appear.

CHIEF JUSTICE ROBERTS: Why are those -- why are those the key words? Why don't you start earlier? "Knowingly alter, destroy, mutilate, conceal, cover up, falsify, "those are certainly pertinent in analyzing the reach of "tangible object," aren't they?

MR. MARTINEZ: I think they show that -- that Congress was intending to essentially figure out every way that -- that someone might imagine tampering with or destroying or -- or obstructing justice by getting rid of evidence, and so they might shed light on it. But the issue in this case is the meaning of -- of the phrase "any tangible object."

I would like to --

JUSTICE GINSBURG: Are you -- are you then saying that this is, indeed, a general statute against destroying anything that would impede a Federal --

MR. MARTINEZ: We think this is a general statute that would cover destroying any record, document, or tangible object, which we think, as a manner of plain meaning and history covers all types of -- of physical evidence.

JUSTICE KENNEDY: Assume that Congress intended and wanted, to cure a void in the criminal statutes, to have a general prohibition against destruction of evidence and that it put it in Sarbanes-Oxley, and you make that argument. Are there any other laws of general application that were also included in the Sarbanes Act -- Oxley, or is this the only one?

MR. MARTINEZ: No, there -- there were a number. First of all, Petitioner has conceded that 1512(c)(1) itself is of general application. The other one that I think is the clearest to point to would be 1513(e), which was a new provision also added as part of Sarbanes-Oxley that was the antiretaliation provision. And --

JUSTICE SCALIA: Is there any other provision of Federal law that has a lesser penalty than 20 years that could have been applied to this -- this captain throwing a fish overboard?

MR. MARTINEZ: Well, Your Honor, he was convicted of violating 2232. The statute that Petitioner agreed he could have been charged with, 1512(c)(1), also applies a 20-year penalty.

But I'd like to address --

JUSTICE SCALIA: And that's it?

JUSTICE BREYER: They never meant to --

JUSTICE SCALIA: There is nothing lesser than that?

MR. MARTINEZ: I -- I'm sure there -- there may have been other --

JUSTICE SCALIA: You know, frankly, you come here, and, yeah, he only got -- what did he get, 30 days or something?

MR. MARTINEZ: Yes, Your Honor.

JUSTICE SCALIA: But he could have gotten 20 years. What kind of a sensible prosecution is that?

MR. MARTINEZ: Your Honor --

JUSTICE SCALIA: Is there nothing else you -- who -- who do you have out there that -- that exercises prosecutorial discretion? Is this the same guy that -- that brought the prosecution in Bond last term?

MR. MARTINEZ: Your Honor, I think a couple points on that. First of all, Congress passed a broad statute. The statute as originally drafted and reported out of the Senate Judiciary Committee had a 5-year penalty. Congress looked very closely at that penalty. It was -- sorry, it was drafted with 5 years. It was reported out of committee with 10 years, and it was ultimately at -- at the suggestion of the House of

Representatives, upped to 20 years.

JUSTICE SCALIA: No, I'm not talking about Congress. I'm talking about the prosecutor. What kind of a mad prosecutor would try to send this guy up for 20 years or risk sending him up for 20 years?

MR. MARTINEZ: Your Honor, we did not ask for 20 years in this prosecution. And let me try to explain --

JUSTICE GINSBURG: But you did -- you did -- you did charge --

JUSTICE KENNEDY: What did you ask for?

JUSTICE GINSBURG: You charged two offenses: 2232, and Yates is not questioning the applicability of that. Is there any guidance that comes from Justice to prosecutors? I mean, the code is filled with overlapping offenses. So here's a case where the one statute has a 5-year maximum, the other 20. The one that has the 5-year clearly covers the situation.

Is there anything in any kind of manual in the Department of Justice that instructs U.S. attorneys what to do when there are these overlapping statutes?

MR. MARTINEZ: Your Honor, the -- my understanding of the U.S. Attorney's Manual is that the general guidance that's given is that the prosecutor should charge -- once the decision is made to bring a

criminal prosecution, the prosecutor should charge the -- the offense that's the most severe under the law. That's not a hard and fast rule, but that's kind of the default principle. In this case that was Section 1519.

JUSTICE SCALIA: Well, if that's going to be the Justice Department's position, then we're going to have to be much more careful about how extensive statutes are. I mean, if you're saying we're always going to prosecute the most severe, I'm going to be very careful about how severe I make statutes.

MR. MARTINEZ: Your Honor, that's --

JUSTICE SCALIA: Or -- or how much coverage I give to severe statutes.

MR. MARTINEZ: That's -- that's not what we were saying. I think we're not always going to prosecute every case, and obviously we're going to exercise our discretion. In this case, what the prosecutors did was they looked at the circumstances of the offense. And just to emphasize what happened here, Mr. Yates was given an explicit instruction by a law enforcement officer to preserve evidence of his violation of Federal law. He directly disobeyed that. He then launched a -- a convoluted cover-up scheme to -- to cover up the fact that he had destroyed the evidence. He enlisted other people, including his crew members, in

executing that scheme and in lying to the law enforcement officers about it. And then --

CHIEF JUSTICE ROBERTS: You make him sound like a mob boss or something. I mean, he was caught --

(Laughter.)

CHIEF JUSTICE ROBERTS: The fish were -- how many inches short of permitted were the fish?

MR. MARTINEZ: The fish were -- it varied fish by fish, Your Honor.

(Laughter.)

MR. MARTINEZ: But we did not -- the prosecution in this case was not about the size of the fish. The prosecution was about the destruction of the evidence, and I think it would be a very strange thing if this Court were to say that the obstruction of justice law is somehow applied differently when the offense is trivial.

JUSTICE KENNEDY: Did you ask -- did you ask for or recommend a particular sentence?

MR. MARTINEZ: We asked for a sentence within the guidelines range which was -- which was calculated by the judge at I think 21 to 27 months. The judge ended up giving 30 days. We did not appeal that. We think, you know, that was a reasonable exercise of the judge's discretion, which I think is a very

important check on the fact that this is, of course, a very broad statute, and I think a 20-year penalty, of course, would -- would have been too -- too much in this circumstance.

CHIEF JUSTICE ROBERTS: But according --

JUSTICE KENNEDY: Go ahead.

CHIEF JUSTICE ROBERTS: But according -- if I understand your answer to Justice Scalia, according to the Justice Department manual, any case in which someone destroys a tangible object, you -- you should prosecute them under this statute, because I assume 20 years is the maximum available penalty?

MR. MARTINEZ: Your Honor, we would not -- we do not prosecute every fish disposal case, and -- we do not. So I think if you --

CHIEF JUSTICE ROBERTS: But the point is that you could, and the point is that once you can, every time you get somebody who is throwing fish overboard, you can go to him and say: Look, if we prosecute you you're facing 20 years, so why don't you plead to a year, or something like that. It's an extraordinary leverage that the broadest interpretation of this statute would give Federal prosecutors.

MR. MARTINEZ: Your Honor, we're operating with the -- with the statute that Congress passed, and

Congress decided that this statute was going to carry a 20-year penalty. And I think the issue in this case, though, is whether Mr. Yates' conduct comes within the terms of that statute and specifically whether a fish counts as a tangible object.

JUSTICE BREYER: Isn't -- isn't there a normal obstruction of justice statute that existed before this?

MR. MARTINEZ: I -- there are several, and I think what Congress --

JUSTICE BREYER: Suppose, in other words, it -- wasn't this going to a criminal -- isn't a criminal matter?

MR. MARTINEZ: I'm sorry, can you --

JUSTICE BREYER: Wasn't what the official, the government official was investigating a minor crime, catching fish that are too small? Am I right?

MR. MARTINEZ: It was a civil offense, Your Honor, that the --

JUSTICE BREYER: It's a civil offense.

MR. MARTINEZ: Yes.

JUSTICE BREYER: Fine. Then isn't there a statute that says that you cannot destroy evidence useful for a civil offense when you know that it's going to be?

MR. MARTINEZ: Yes, and it's 1519 and only 1519.

JUSTICE BREYER: In other words, for many, many years before Sarbanes-Oxley, the Federal Government could not prosecute obstruction of justice.

MR. MARTINEZ: Your Honor, the --

JUSTICE BREYER: Where there was a civil offense involved?

MR. MARTINEZ: When there was a -- in the absence of a pending judicial proceeding, the government could not have prosecuted him under 1503.

JUSTICE BREYER: No, I'm not asking specific things. I want to know the general criminal law, which I do not know all of it. I had always thought there is a crime called obstruction of justice, and I always thought that a person who destroys evidence, where he knows it's evidence, he's been asked to bring it to the proceeding which may not yet have taken place, he purposely destroys it, I had thought that that was a crime.

MR. MARTINEZ: It would make perfect sense for that to be a crime --

JUSTICE BREYER: But it was never was in the criminal system? No one was ever prosecuted for it?

MR. MARTINEZ: Under these -- under these

circumstances it was not a -- it was not a crime, and that's exactly what Congress realized.

JUSTICE SOTOMAYOR: I'm sorry --

MR. MARTINEZ: -- in the wake of Enron.

JUSTICE SOTOMAYOR: I'm sorry, but --

JUSTICE BREYER: What statute did you used to use?

MR. MARTINEZ: Well, in the Arthur Andersen prosecution they used 1512(b)(2). But the problem with 1512(b)(2) was that it had a huge loophole in it. 1512(b)(2) prohibited person A from persuading person B to destroy evidence, but it didn't prohibit person A from destroying that exact same evidence himself. And so Congress decided --

JUSTICE BREYER: Okay, okay. I guess I can look that up later. But in any case, this is a -- what will you do with the problem that I put together? That is my problem.

MR. MARTINEZ: The vague -- the potential vagueness problem? Is that what --

JUSTICE BREYER: Yeah.

MR. MARTINEZ: I think there are certain questions that come into play with this statute, which are arguably vague, and they don't have to do with the meaning of tangible object. They have to do with the --

the various intent-related elements of the statute. For example, what does it mean to impede, obstruct or influence justice? What does it mean to be acting in contemplation of a proceeding, and do you need to know that the proceeding is -- is under Federal jurisdiction? Those are the kinds of questions that the lower courts are currently dealing with. They're not presented in this case.

JUSTICE BREYER: No, I know. It's not just influence a proceeding. It is, for example -- and here it's obscure, but it means to destroy something in relation to any such matter or case. What matter? In relation to any matter within the jurisdiction of any department or agency within the United States. What?

(Laughter.)

JUSTICE BREYER: I mean, somebody comes to the door and says -- I've been through this. He passes a piece of paper through the door. It's the postal -- it's a postman. He says, please send this back. It's our proper duty to deliver the mail. I say, I hate postmen and I rip it up. 20 years.

(Laughter.)

MR. MARTINEZ: Your Honor, that would not be covered.

(Laughter.)

JUSTICE BREYER: And why wouldn't it happen? It wouldn't happen because you'd never prosecute it, though I've had my doubts recently.

(Laughter.)

MR. MARTINEZ: Your Honor, it wouldn't happen because the statute requires bad intent. It requires the intent to impede, obstruct --

JUSTICE BREYER: Yes, I do. I say, I hate postmen. I don't want them to find out. And I tell four people, I finally got even with the postman. I have -- I have the intent.

And I'm using a ridiculous example purposely because, by using an example purposely, I'm trying to get you to focus on the question of how possibly to draw a line. And if you can't draw a line, it seems to me that the risk of arbitrary and discriminatory enforcement is a real one. And if that's a real risk, you fall within the vagueness doctrine. There is the whole problem spelled out, and what I do not understand is the relation of this case to that doctrine or how to decide this case.

MR. MARTINEZ: Your Honor, this case is -- is not related to that doctrine because the Petitioner has not made a vagueness argument.

JUSTICE BREYER: Yes.

MR. MARTINEZ: What this Court has said is that when -- when vagueness challenge is represented, they need to be presented in as-applied challenges. That hasn't happened in this case, and so --

JUSTICE BREYER: How do I know since there could be four ways of trying to limit it? And one way to try to limit it might be what your opponent says.

MR. MARTINEZ: I think that his way is a particularly bad way to address the problem that you -- the exact hypothetical that you gave me because in that case, we're talking about a document, a letter, that the postman hands over. And so the problem that -- that your -- your hypothetical poses is not addressed by the solution he gives.

JUSTICE BREYER: That's true.

MR. MARTINEZ: So there's a total mismatch. And I don't think there's any reason to think that Congress, even if it had concerns about breadth, would have wanted to solve those concerns by -- by narrowing, in a very unnatural fashion, the word "tangible object," whereas, you know, leaving in place the terms "record and document."

JUSTICE SOTOMAYOR: Mr. Martinez, can we go back to what we started with -- with what Justice Breyer started with? If I understood your brief right, up

until 1519, the general obstruction statute, 1503, applied only to the destruction of evidence in a judicial proceeding if you got someone else to destroy it.

MR. MARTINEZ: 1503 applied only to pending judicial proceedings. There was a different provision, Section 1512(b)(2) that, as -- as the Court considered and addressed in the Arthur Andersen prosecution, 1512 (b)(2) did not prohibit a single act or destruction. You had to persuade someone else.

JUSTICE SOTOMAYOR: Okay. So you needed something to punish people who destroyed evidence and -- but I see two provisions, 1519 and 1512. Are they superfluous?

MR. MARTINEZ: I think the way to understand those provisions is to -- is to understand the fact that, one, they are super -- they are redundant largely, not entirely; and, two, why are they both in there? It's a very reasonable question to ask. And the reason is, these were rival -- essentially rival provisions, they were drafted by different people at different times and they both ended up in the statute by the way that the --

JUSTICE SCALIA: Well, that makes it okay. That's fine. I mean, you know, that explains how it

happens. It doesn't explain how it makes any sense.

(Laughter.)

MR. MARTINEZ: Well, Your Honor, I think to address the -- the textual component of the superfluous nature of those two provisions, I think it's unambiguous that they are superfluous, and I think Petitioner would agree with us that they're superfluous with respect to records and documents. So we know here that Congress was not intending to avoid surplusage. The only question is whether they also -- they -- they thought it would be superfluous with the third term in the list, which is either "other objects" or "tangible objects."

JUSTICE SCALIA: Well, not only that, 1519 -- 1512 only applies for use in an official proceeding; isn't -- isn't that right?

MR. MARTINEZ: That's right. It's narrower.

JUSTICE SCALIA: Yes. And this applies to any matter within the jurisdiction of any department or agency of the United States. Is the knowingly requirement of 1519, does that apply to that portion of the statute or does it only apply to altering, destroying, mutilating, concealing, covering up, or falsifying?

Do you have to know that it is within the jurisdiction of a -- of a Federal agency?

MR. MARTINEZ: No, you don't. It's a jurisdictional element that typically that it -- as this Court has read other statutes, the -- the knowledge requirement does not extend to the jurisdictional element.

JUSTICE SCALIA: Wow. Then it's really --

MR. MARTINEZ: Your Honor, but that's -- the court of appeals have said that if this Court has concerns with that -- that holding, I think there may be a different case in which to bring that up. Here, of course, Mr. Yates had perfect knowledge that there was a Federal proceeding that was ongoing and so that concern doesn't affect his case.

JUSTICE SCALIA: In this case, it's not a problem.

MR. MARTINEZ: But -- can I --

JUSTICE SOTOMAYOR: 1512, could you have charged it?

MR. MARTINEZ: 1512(c)(1), I think we could have charged it, yes, Your Honor. And we didn't -- and I think in the Eleventh Circuit there was some confusion about how you deal with investigations and whether investigations that are probably going to give rise to a proceeding, whether that kind of is close enough to an official proceeding to charge 1512(c)(1), so they made

the decision to charge 1519 instead. It was -- it was a reasonable decision based on the language of the statute.

But I want to emphasize, I think the most important thing that Petitioner's counsel conceded here today was that 1512(c)(1) is a general obstruction of justice statute that was passed as part of Sarbanes-Oxley and covers the destruction of fish. And I think that --

JUSTICE GINSBURG: He said it has a stronger state of mind element.

MR. MARTINEZ: It's -- the requirement is a little bit more rigorous with respect to 1512(c)(1). But I think the key point is Sarbanes-Oxley prohibits the destruction of fish. You said that, that's been our position, and I think that undermines the whole theme of his brief and certainly the theme of all the amicus -- amicus briefs that's been -- that have been filed here.

Their whole point has been it's impossible to imagine that -- that Sarbanes -- that Congress could have wanted Sarbanes-Oxley, an Enron-related statute, to prohibit the destruction of fish, and yet that's the point on which we all agree here today.

I'd like to say a few words about the various textual arguments that -- that Petitioner has

put forward, the nouns, the verbs and the headings. First of all, with respect to -- with respect to the nouns, I think the historical evidence that we've put forward, I think, show conclusively that the term "record," "document," and "tangible things" is very, very similar to the standard formulation that essentially everyone has used to cover all physical evidence in the obstruction of justice context for over five decades.

Secondly, 1512(c)(1) confirms that the -- the --

JUSTICE KAGAN: Could -- could you tell me, Mr. Martinez, where are those other provisions? I -- I think that there are about five of them in 1512. I take it there are many State statutes, are there? Are there other Federal statutes?

MR. MARTINEZ: We -- the -- the key provisions that we've pointed to in our brief, there's six different provisions of Section 1512. 1512 (a)(1)(b), (a)(2)(b)(1).

JUSTICE KAGAN: That's okay.

MR. MARTINEZ: Okay. So there's six in 1512. There's 16 different State provisions that have essentially the same language. I think most of them say "record," "document" or "thing." Some of them say

"record," "document" or "other object."

CHIEF JUSTICE ROBERTS: Well, but -- when you say this -- I understood your friend to say "tangible object" is only used in record statutes. In 1512 --

MR. MARTINEZ: No.

CHIEF JUSTICE ROBERTS: -- it's -- it's "object," I mean tangible -- yeah, "tangible thing." In 1512 it's "object," right?

MR. MARTINEZ: In 1512 it's "other object."

CHIEF JUSTICE ROBERTS: Well, see, the reason -- I mean, maybe that makes a difference if you have records, documents, and then a tangible object suggests that the tangible nature of it is what's significant, which suggests that it may be one of the -- you know, whatever the drive thing is as opposed to a record. And that's a point that's not present in the statutes that you were citing.

MR. MARTINEZ: I think -- I think it's true that the term "tangible" is different. I think that the way to understand the term "tangible" is the way in which Congress and -- and the rules always use the term "tangible" in connection with things or objects, which is as a way to refer to all types of -- of objects, all types of evidence.

We've cited 35 different provisions of the U.S. Code and of the -- the discovery rules in the criminal context and in the civil context. Those are at Footnote 3 of our brief. In all of those instances, they use the phrase "tangible things" or "tangible object" to refer to everything. And so there's no reason to think that the addition of the word "tangible" somehow shrunk the scope of the statute. And even if it did shrink --

JUSTICE SCALIA: Is there such a thing as an intangible object? I'm trying to imagine one.

MR. MARTINEZ: I -- I think the -- you could say that the object of the game of Monopoly is to win all the money, but that's not really what Congress was looking at here.

(Laughter.)

JUSTICE SCALIA: Object not meaning purpose.

MR. MARTINEZ: I -- I don't think that the word -- I agree with what Petitioner said in his opening brief, which is that -- that the word "tangible" here doesn't really do much. He said that at page 13 of his opening brief. When you get to his reply brief, suddenly the word "tangible" is doing all this amazing work that -- and it's the key difference between this statute and all the other statutes. So that's with

respect --

JUSTICE GINSBURG: You, in your brief, point to the Model Penal Code as the model for 1519. But the Model Penal Code describes a misdemeanor, and this is a 20-year felony. That seems kind of a mismatch.

MR. MARTINEZ: You know, if -- the tradition of -- of the degree of penalty to attach to this offense has changed over time. As you point out, the Model Penal Code did identify this as a misdemeanor. The Brown Commission, which built on the Model Penal Code, treated it as a misdemeanor or as a felony, depending on the severity of the underlying offense.

When Congress sat down in the '70s and '80s and was trying to incorporate, essentially, that provision into Federal law unsuccessfully, over a dozen times it treated it as a felony. And then, or course, Congress in Sarbanes-Oxley Act in both 1512(c)(1) and in 1519 also treated it as a felony with a 20-year penalty. And -- and with respect to that penalty, again, I think it's important to emphasize that the text that's at issue here, any tangible object, that was fixed and that was drafted -- it was in the bill that was introduced by Senator Leahy at the time when it was only a 5-year penalty. And there's no reason to think that when Congress tinkered with that penalty, it meant to kind

of, by implication, shrink the scope of tangible objects that's at issue here.

And I think just to emphasize the -- the textual point, it's -- it's a very unusual and I think it's -- it's highly implausible to believe that Congress chose this broad and expansive phrase, "any tangible object," when really what it really wanted to do was refer only to a very narrow and specific category of information storage devices.

CHIEF JUSTICE ROBERTS: Well, isn't that like the Bond decision? I mean, you had text that could be read broadly, and yet we suggested, well, Congress could not have meant the Chemical Weapons Treaty to cover a minor dusting of -- with toxic, irritating chemicals.

MR. MARTINEZ: I think Bond it's -- I think Bond is actually in some ways helpful to the government in this case. Because as I understand the -- the Bond decision, it turned essentially on the everyday meaning of -- of the phrase and of -- and Federalism concerns as well. And the everyday meaning of the phrase -- I think it was "chemical weapon" in that case -- didn't apply to -- to the chemicals at issue that Miss Bond used.

But in this case, the everyday meaning of the phrase "tangible object" applies to all tangible

objects. Everyone -- and if you stop someone on the street and ask them is a fish a tangible object, the answer would almost certainly be -- would be yes. And so, you don't have as well what you had in Bond, which was the concern about -- about Federalism and the application of that canon.

CHIEF JUSTICE ROBERTS: Well, what if you stopped them on the street and said is a fish record document or tangible object?

MR. MARTINEZ: I think if you -- if you asked them that question and you -- you pointed them to the fact that --

JUSTICE SCALIA: I don't think you would get a polite answer to either of those questions.

(Laughter).

MR. MARTINEZ: Your Honor, maybe I could say a word -- having talked about the nouns, maybe I could say a word about the verbs in this statute because they make a -- they place a lot of emphasis on the "makes a false entry" language. Petitioner's argument rests on this premise that each of the verbs has to work with -- with each of the nouns, but that premise is -- is flawed. It's not consistent with how Congress drafts statutes, it's not consistent with Petitioner's own interpretation, and I think there's significant tension

with this Court's decision last year in Roberts. Let me say a word about each.

With respect to how Congress drafts statutes, I think you only have to look to Section 1505 of the statute to see that that's yet another example of where Congress has used -- had a bunch of verbs and a bunch of nouns and some of the nouns don't work with some of the verbs. You can't mutilate oral testimony. With respect to Petitioner, the inconsistency with Petitioner's own theory, Petitioner agrees that 1519 covers the destruction of an e-mail in electronic form. You can't mutilate an e-mail. No one would ever talk like that.

Similarly, he says that it would apply to a blank hard drive. But no one -- I've never heard anyone talk about falsifying a blank hard drive. So the implications of his argument are inconsistent with -- with where he wants the Court to go. And then finally, the Roberts case. Roberts dealt with a circumstance, it wasn't perfectly analogous, but it was -- it raised a similar problem, which is that there was a broad statute, it had many different applications, and there was some language in the statute that was a little bit awkward and a little bit superfluous with regard to some of the applications of the statute.

And the response that the Court had to that problem was not to say, well, the statute doesn't apply to those circumstances. The response was to say that that's the linguistic price to be paid, linguistic price to be paid for having a broad statute. And then the Court said Congress does not need to write extra language specifically exempting, phrase by phrase, applications with respect to which a portion of a phrase is not needed. I think that was right in Roberts and I think the same principle applies here.

Finally, Your Honor, with respect to the headings, a couple points. First, I think the headings in this case as in -- as in the Lawson case that this Court also dealt with last term also involving Sarbanes-Oxley, the headings here are just obviously and unambiguously under inclusive. The heading is a shorthand reference to the general subject matter. It's not intended to spell out what the operative provisions say or to mirror those operative provisions. It's obviously under inclusive. It omits a whole bunch of the verbs. It omits two of the nouns. The heading argument, I think, is especially unreliable in this context where if you look at what Congress did with Sarbanes-Oxley generally, it was not paying very close attention to the headings under which it put various

provisions.

That's true with respect to 1519, that's true with respect to 1514, the statute that was at issue in the Lawson case, and it's also true with respect to Section 1512(c)(1). Section 1512(c)(1) prohibits me from -- prohibits any person from destroying evidence. But they put that -- that provision inside the witness-tampering statute. It doesn't make sense; it doesn't fit there. And that just shows that Congress was not paying close attention to the headings and that that shouldn't drive the outcome of this case.

JUSTICE ALITO: Well, Mr. Martinez, you are really -- I mean, you have arguments on all of these points, but you are really asking the Court to swallow something that is pretty hard to swallow. Do you deny that this statute, as you read it, is capable of being applied to really trivial matters, and yet each of those would carry a potential penalty of 20 years, and then you go further and say that it is the policy of the Justice Department that this has to be applied in every one of those crazy little cases. And this involved a business and a number of fish. What if it was one fish? What if it was one undersized fish that was caught by a fisherman in a national -- on Federal land? This would be -- would it apply here?

MR. MARTINEZ: Your Honor, I want to answer that question, but I just want to clarify what I said about our policy. Our policy is not that we prosecute every trivial matter. That is not our policy. I want to be very clear about that.

JUSTICE ALITO: No, I understand that. But if you choose to -- if you want to find the guy who caught one trout that was undersized on Federal -- on a Federal -- on Federal land, you want to charge him with whatever regulatory offense that would be, you have to charge this, too, because this is the more severe penalty.

MR. MARTINEZ: We only have to charge this if -- if the person with knowledge and the intent to obstruct the administration of Federal law deliberately takes that one fish and throws it overboard or destroys it so as to escape liability.

JUSTICE BREYER: What about every camper --

MR. MARTINEZ: That's what the statute says.

JUSTICE ALITO: He catches the fish and now he sees the inspector coming toward him, throws it in the lake.

MR. MARTINEZ: That's what the statute says, Your Honor. Now, I -- I appreciate the force of the hypothetical and I understand it, but I think I want

to -- the point I want to emphasize, because maybe there's -- I understand why the Court might have concerns about that. The problem -- there's a mismatch, though, between Petitioner's argument and the hypothetical.

The problem with the hypothetical is that this statute might be harsh in certain particular outlier applications. But Petitioner is not arguing for some sort of de minimis rule, he's not saying that this statute can't be applied in trivial cases. He's arguing that an entire class of evidence is entirely outside the scope of the statute --

JUSTICE KENNEDY: But he has no -- he has no doctrinal basis to make that argument other than to say that there is such a doctrine as prosecutorial discretion and, A, that it's enforceable and, B, that it has some substance, and you've indicated that it has neither.

MR. MARTINEZ: I -- I think, Your Honor, I don't think that -- I think prosecutorial discretion is not an issue that he's raised. I don't think that it's an issue in light of this Court -- what this Court has said about prosecutorial discretion. I don't think that would be a basis --

JUSTICE KENNEDY: Well, it seems to me that

we should just not use the concept or refer to the concept at all anymore.

MR. MARTINEZ: Well, Your Honor, I think that -- that -- again, to go back to some of the answers I was -- I was giving earlier, I think that the concerns that the Court has flagged about the potential breadth of this statute, they're serious and they're the kinds of concerns that courts and juries and judges are going to take into consideration when they're dealing with any of these crimes. But the issue in this case is not -- is not that. The issue in this case is what is -- what did Congress intend with the term "any tangible object."

JUSTICE BREYER: All right. So if that's so, then that's the dilemma. Suppose I worry about Justice Alito's single fish in the case of a camper who kicks an ember away, knowing you shouldn't have built the campfire or picks a flower, knowing you're supposed to let wildflowers blossom. What about that 20 years, and you could multiply those beyond belief. So if that's the problem, does his client go to prison because we've just assumed that problem away from the case?

MR. MARTINEZ: No, we do not --

JUSTICE BREYER: How -- how do we handle it if, as you say, there is a genuine concern in that respect, but it wasn't argued here?

MR. MARTINEZ: I think that you write a very narrow decision that says this case is about the meaning of the term "any tangible object." And if the case -- the ember case comes up or the postman case comes up, then -- and if the arguments are made, then I think those arguments can be fleshed out, they can be briefed, they can be thought through by the parties, and I think they'll be properly presented to the Court in that case.

In this case, though, this case presents just a common sense, straightforward question of statutory interpretation. Does the phrase "any tangible object" actually mean what Congress said? Does it refer to all tangible objects? We think that the unambiguous answer based on the text of the statute, based on the history of the statute, is -- is clearly yes, and we ask this Court to affirm.

JUSTICE KENNEDY: Perhaps Congress should have called this the Sarbanes-Oxley Grouper Act.

(Laughter.)

MR. MARTINEZ: Perhaps, Your Honor.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

Mr. Badalamenti, you have four minutes remaining.

REBUTTAL ARGUMENT OF MR. BADALAMENTI

ON BEHALF OF THE PETITIONER

MR. BADALAMENTI: I'll be brief. Regarding Justice Breyer's question regarding the void for vagueness, the government stated that we had not stated that in our brief. It's on pages 25 and 26, as well as squarely raised in Footnote 7.

JUSTICE BREYER: Yes, but it wasn't raised below. And these are very difficult issues and it's sort of flying blind not to have lower court opinions and the thing fully argued out before we get it.

MR. BADALAMENTI: Yes, Your Honor. We just wanted to point out where it was in the briefing in this -- in this Court.

The "tangible object" notion is extremely important, which the justices have pointed out under Russello. You have the fact that you have two statutes passed in the same act. One includes different language than the other. To presume that that language is included in there intentionally and that major significance makes false entry in all of the statutes that are -- we've cited in our brief in Footnote 4, that reference of the reply brief -- all of them are record-related statutes. Every single one of them has a textural indication of what Congress had meant.

The breadth of the statute regarding any Federal matter is -- is an extraordinary thing that the

American people will be walking on eggshells for if this Court were to not limit, at least, the subject matter of this. And the last point --

JUSTICE SCALIA: Of course, it doesn't entirely solve that problem, simply to narrow --

MR. BADALAMENTI: It does not -- it doesn't, Your Honor. And Mr. Yates would open up any other constitutional issues as well. But no, certainly the last comment is directed -- is that for more than 200 years, the United States has existed without this mega, all-inclusive obstruction of justice statute with the intent to impede anything, any matter, that the possibility of the United States could or may or may never be interested in. It didn't create it buried within the Sarbanes-Oxley Act and this Court shouldn't put it in there now.

For these reasons, Mr. Yates requests that this Court vacate the conviction under Section 1519, reverse, remand the decision to the Eleventh Circuit.

Thank you.

CHIEF JUSTICE ROBERTS: Thank you, counsel. The case is submitted.

(Whereupon, at 11:03 a.m., the case in the above-entitled matter was submitted.)

TONE AT THE TOP:

HOW MANAGEMENT CAN PREVENT FRAUD IN THE WORKPLACE

PRESENTED BY THE ASSOCIATION OF CERTIFIED FRAUD EXAMINERS

WHAT IS THE "TONE AT THE TOP"?

The connection between fraud and the "tone at the top" of an organization has received international attention over the last few years. Tone at the top refers to the ethical atmosphere that is created in the workplace by the organization's leadership. Whatever tone management sets will have a trickle-down effect on employees of the company. If the tone set by managers upholds ethics and integrity, employees will be more inclined to uphold those same values. However, if upper management appears unconcerned with ethics and focuses solely on the bottom line, employees will be more prone to commit fraud because they feel that ethical conduct is not a focus or priority within the organization. Employees pay close attention to the behavior and actions of their bosses, and they follow their lead. In short, employees will do what they witness their bosses doing.

Corporate greed at the executive level has destroyed hundreds of companies, drained stockholders of their investments, and left innocent employees without work. Ken Lay, Jeffrey Skilling, and Andrew Fastow from Enron; Bernie Ebbers from MCI/WorldCom; and Dennis Kozlowski at Tyco have become household names, and to many are synonymous with what is wrong with our corporate system. Furthermore, these individuals represent only a small percentage of the executives who have abused their posts of power to commit corporate fraud. Over 100 public company CEOs have been sued over the last five years for committing white collar crimes. These CEO criminals were sending a clear (though perhaps unintentional) message to their employees that *committing fraud is acceptable as long as it makes the company seem profitable*. They were obviously not setting an ethical tone at the top for their employees.

It is crucial to a company's success for executives and management to set an ethical example (or tone) of how their employees should behave in the workplace. When those in top positions set the wrong, unethical example by committing fraud, their employees will take heed and follow in their bosses' fraudulent footsteps, creating an entire culture of workplace fraud. When executives put pressure on their employees to meet unrealistic goals to yield profits for the company, they are essentially forcing employees to do whatever it takes to achieve those goals, whether they achieve those goals improperly or not. In their minds, the end justifies the means.

The National Commission on Fraudulent Reporting (called the Treadway Commission) released a groundbreaking study in 1987 that reported the casual factors that lead to fraudulent behavior and financial statement fraud. According to the Commission, the tone at

the top plays a crucial and influential role in creating an environment in which fraudulent financial reporting is ripe to take place.

To set the right tone, those in top positions of management have to follow four very important steps: communicate to employees what is expected of them; lead by example; provide a safe mechanism for reporting violations; and reward integrity. These steps will be discussed in greater detail throughout this presentation.

Story of a convicted criminal: Walt Pavlo

Walt Pavlo is a convicted white-collar criminal who claims that he was pressured by his bosses to commit financial statement fraud at MCI/WorldCom. In January of 2001, Pavlo received a 41-month federal prison sentence for money laundering, wire fraud, and obstruction of justice. He was a Senior Manager in Billing Collections at MCI/WorldCom and dealt with customer payments, credits, and reconciliations of accounts. He felt pressure from upper level management at MCI/WorldCom to constantly achieve revenue growth in the company. Revenue projections for the company were laid out beforehand for each period, and employees were pressured to meet or exceed these projections. As Pavlo watched his bosses manipulate the company's financial records, he soon began to manipulate them himself. Soon after, Pavlo's own employees would learn to conduct fraudulent activity under their boss. Pavlo and his supervisors met to devise ideas on how to cook the company's books. Financial records were manipulated by Pavlo, his superiors, and his colleagues in a widespread effort to fraudulently make the company look like it was meeting revenue growth projections, even though it wasn't. Pavlo learned how to conceal uncollectible debt, which boosted the company's assets and profits. Auditors eventually found unusual journal entries made by Pavlo and confronted him about it. It was then that he confessed to his fraudulent behavior.

Similar to many other people who commit white collar crime, Pavlo didn't feel as though he was doing anything wrong in the beginning. He felt that he was doing his job and making his employers happy by altering the company's financial data. In the long run, he incorrectly thought, the problem would remedy itself.

Even a highly-educated and well-experienced employee can become a white collar criminal. Pavlo received an Industrial Engineering degree from West Virginia University and his MBA from the Stetson School of Business at Mercer University in Atlanta, Georgia. He left behind his wife and two young sons when he served a two-year prison sentence for his financial crimes.

Major Fraud factors

There were three major factors that played a role in Walt Pavlo's downfall. These factors are also common in many other fraud cases, particularly in larger companies. The fraud factors present in Walt's case were:

- Meeting analysts' expectations – Upper management and employees can become preoccupied with meeting analysts' expectations. This preoccupation can lead to the pressure to commit fraud. In the case of Walt Pavlo, he felt extreme pressure from his

superiors to meet revenue projections. Employees and executives alike knew where the numbers needed to be in order to meet those projections, and they would meet to discuss different ways to manipulate the records so that it looked like MCI/WorldCom was living up to analysts' expectations.

- Compensation and incentives -- Compensation and incentive plans may encourage unacceptable, unethical, and illegal conduct. In Pavlo's case, in addition to his annual salary, he was eligible for thousands of dollars in stock options each year if he was able to meet his financial targets. He knew there was a financial incentive for cooking the books, so he manipulated the numbers. This created a financial gain for him and kept his bosses happy at the same time.

- Pressure to reach goals – The degree of fear and pressure associated with meeting numerical goals and targets also play a major role in fraud. It goes without saying that the more pressure and fear that an employee feels to meet revenue goals, the more likely they are to do whatever it takes to meet those goals. Pavlo stated that he learned how to conceal uncollectible debt and artificially boost the company's assets and profits from his supervisors . With their help, he delayed write-offs and made the revenue numbers seem more attractive by making them look like they were collectible. Not only was this unethical, it was also illegal.

Common Ethical Violations

According to the 2005 National Business Ethics Study, the falsification and misrepresentation of financial records constituted 5 percent of the ethical violations reported in its survey. The other common types of ethical violations observed by employees (as well as their corresponding percentages) in the workplace were:

- Abusive or intimidating behavior of superiors toward employees (21 percent)
- Lying to employees, customers, vendors, or the public (19 percent)
- A situation that places employee interests over organizational interests (18 percent)
- Violations of safety regulations (16 percent)
- Misreporting actual time or hours worked (16 percent)
- E-mail and Internet abuse (13 percent)
- Discrimination on the basis of race, color, gender, age, or similar categories (12 percent)
- Stealing, theft, or related fraud (11 percent)
- Sexual harassment (9 percent)
- Provision of goods or services that fail to meet specifications (8 percent)
- Misuse of confidential information (7 percent)
- Price fixing (3 percent)
- Giving or accepting bribes, kickbacks, or inappropriate gifts (3 percent)

The NBES points out that every organization needs to be able to answer this question: How much misconduct is considered acceptable/inevitable within the company? This question will help prepare upper management to focus on how it deals with the problem of employee behavior.

Why employees don't report unethical conduct

Obviously, there are many different forms of misconduct that go on in the workplace and are observed by employees every year. Yet, many employees do not report this unethical conduct. According to the National Business Ethics Survey, only 55 percent of employees in 2005 said that they reported misconduct that they observed in the workplace. This was a 10 percent decrease from the previous survey in 2003.

In the past, employees under age 30 with little tenure (less than three years) were the least likely of any group to report ethical misconduct. This was due to their fear of retaliation from management and coworkers. They also felt that managers would consider them "trouble makers" if they reported unethical conduct. Middle managers and senior managers were most likely to report misconduct. However, in 2005, there was no significant statistical relationship between age/tenure and reporting. The top reasons for not reporting unethical conduct, according to the 45 percent of employees who *did not* report misconduct, are:

- No corrective action – Employees who were cynical of their organizations felt that nothing would be done if they came forward and reported the misconduct that they observed. In 2005, 59 percent of those who did not report misconduct felt as though no corrective action would be taken if they *had* reported unethical conduct. However, the NBES states that these employees may have had an unrealistic expectation for how organizations should handle misconduct reports. Privacy restrictions may prevent the company from telling the whistleblower how the report was handled and what punishments were assessed to the suspicious perpetrator. The company should stress the privacy factor in order to boost confidence in these employees that their reporting will be handled appropriately, even if the whistleblower may not find out about it.

- No confidentiality of reports – Another concern for those who do not report misconduct is the fear that if they were to come forward with a report, their identities, as well as their suspicions, would be revealed.

- Retaliation by superiors – Not surprisingly, this same group of employees also felt that if their identities were exposed, they would have to suffer retaliation from the superiors. The fear of retaliation caused them not to report misconduct.

- Retaliation by coworkers – Similar to retaliation by superiors, employees who withheld reporting unethical behavior in the workplace feared that their coworkers would find out who blew the whistle and retaliate against them.

- Unsure whom to contact – A small number of the employees who did not report misconduct (18 percent in 2005) said they were unclear whom to contact in order to raise their suspicious of unethical conduct.

Employees who witnessed their company actively following its code of ethics were the *most* likely to report misconduct in the workplace, according to the 2005 NBES. They were also more likely to be satisfied with their company's response to reported misconduct. Those who work for organizations that implement formal ethics programs were considerably more prone to reporting the misconduct that they observed. It is important to note that those who

do not report misconduct may have had a poor experience in the past with trying to do so. Executives must reach out to those disenfranchised employees to make sure that they know their identities will be kept confidential if they report unethical behavior in the workplace.

Determinants of ethical behavior

There are certain factors that will determine the likelihood of ethical behavior within an organization. Walt Pavlo took cues from his bosses and his peers to commit fraud, since he was working in an environment that was inundated with fraudulent behavior. The determinants of ethical behavior in an organization are:

- Behavior of superiors – According to the 2005 NBES, employees who feel that top management acts ethically in four important ways (talks about importance of ethics, informs employees, keeps promises, and models ethical behavior) are much less likely to commit fraud, versus those who feel that top management only talks about ethics without exhibiting any action to support their words.

- Behavior of peers – The 2005 NBES research showed that the way in which employees perceive the behavior of their peers can impact their own ethical conduct. Those who observe their peers acting ethically will also be more likely to act ethically; those who observe their peers engaging in misconduct in the workplace will be more prone to engage in misconduct themselves.

- Industry ethical practices – Employees view the ethical practices that they see day-in-and-day-out as normal. If employees work in an industry where particular unethical actions are viewed as standard practice, then those unethical actions begin to seem normal to them. For example, if it is a standard practice in an industry to "pad" hourly billings, then employees may inflate their hourly billings and begin to view such practice as normal and expected. Conversely, employees who work in an environment that strives to maintain ethical conduct will likely view moral practices as normal.

- Society's moral climate – Most people do not want to suffer the humiliation of being scorned by their friends, family, and community due to moral transgressions. However, if society views a particular unethical behavior as tolerable or acceptable, then people are more likely to engage in moral misconduct. For example, in the 1950s, manufacturing companies routinely dumped large amounts of chemical waste into lakes and rivers. There was little societal outrage against the practice. Today, however, such actions are viewed by the public as morally reprehensible.

- Formal organizational policy – It is important for organizations to state that unethical conduct will not be tolerated. It is equally important that the organization follows through in enforcing that policy. If a company consistently "looks the other way" with regard to certain violations, then the employees begin to realize that those violations are not serious ones.

Negative work environment

In a negative work environment, there will be low or nonexistent levels of employee morale or feelings of loyalty to the company. In this setting, employees will be more prone to

committing fraud that will hurt the company, since they feel no obligation to protect it. The following are some of the components that make up a negative work environment, according to the AICPA report "Management Antifraud Programs and Controls: Guidance to Help Prevent, Detect Fraud":

- Top management does not seem to care about or reward appropriate behavior
- Lack of recognition for proper job performance
- Negative feedback
- Perceived organizational inequities
- Autocratic management, rather than participative management
- Unreasonable budget expectations or other financial targets
- Low organizational loyalty
- Fear of delivering "bad news" to supervisors and/or management
- Less-than-competitive compensation
- Poor training and promotional opportunities
- Unfair, unequal or unclear organizational responsibilities
- Poor communication practices or methods within the organization

Positive work environment

Conversely, a positive work environment will help deter fraud while improving the morale and loyalty of employees. According to the AICPA's "Management Antifraud Programs and Controls: Guidance to Help Prevent, Detect Fraud" report, when employees are in a positive work environment, they will be more reluctant to commit fraud that will hurt the organization. When employees have positive feelings about an organization they work for, the occurrence of misconduct is reduced. To create and maintain a positive work environment, management should ensure that:

- Recognition and reward systems are in tandem with goals and results
- Equal employment opportunities exist
- Team-oriented, collaborative decision-making policies are encouraged
- Compensation and training programs are professionally administered

Types of workplace loyalty

In addition to creating a positive work environment, an organization should strive to create an environment that nurtures the highest possible level of loyalty between employees and their company. Employees that demonstrate and feel greater levels of loyalty to their company will be less likely to commit fraud. There are three types of workplace loyalty:

- Personal loyalty is the lowest level of workplace loyalty. It consists of employees' basic acceptance and compliance with the orders of their superiors.

- Institutional loyalty is the next level and is organizational in nature, consisting of accepting and complying with the mission of the organization.

- Integrated loyalty is the highest and most virtuous level of organizational loyalty. It is idealistic in nature for the organization. It transcends the previous loyalties by honoring the ideas of accountability, fairness, honesty, and good will. Organizations should strive

for this level of workplace loyalty in order to protect against fraud and ethical misconduct.

Important considerations of investors

When critically examining an organization's successes and failures, it is necessary to keep the shareholders' goals in mind. Today, investors, analysts, and advisors are taking a close look at the reputation and perceived ethical culture of an organization as part of their evaluation. According to the Corporate Reputation Watch 2004 survey, investors consider the following factors, listed in the order of importance:

- Management team – The caliber of the CEO and the management team is very important to investors.

- Products and services – The quality of products and services is also a crucial consideration to investors.

- Corporate Reputation – Investors pay close attention to the reputation of the corporation. According to the Corporate Reputation Watch 2004 survey, the majority of senior executives surveyed believed that investors and lenders view corporate reputation as important to extremely important, and it is one of the top three factors considered before making investments.

- Governance – Strong corporate governance in an organization is an important factor to investors. More than two-thirds of the senior executives believe that effective governance, transparent disclosures, and reliable financials are essential elements to their company's reputation to the investment community.

Important steps to take

There are several steps that business leaders can take to convey the message of individual and corporate responsibility and accountability to its employees and investors:

- Set an ethical tone at the top – Upper management has to lead by example and actions. These actions should include rewarding ethical behavior while punishing unethical actions. There should be sanctions for engaging in, tolerating, or condoning improper conduct.

- Establish a code of ethics – Organizations should produce a clear statement of management philosophy. It should include concise compliance standards that are consistent with management's ethics policy relevant to business operations. This code of ethics should be given to every employee who will be required to read and sign it. It should also be given to contractors who work on behalf of the organization for their review and signature.

- Carefully screen job applicants – According to the ACFE's *Fraud Examiners Manual*, one of the easiest ways to establish a strong moral tone for an organization is to hire morally-sound employees. Too often, the hiring process is hastily conducted. Organizations should conduct thorough background checks on all new employees,

especially managers and those who will be handling cash. These background checks should include a thorough examination of the candidate's educational credentials, criminal record, history of employment, and references. Speaking with former employers or supervisors can provide valuable information about a person's reputation for trustworthiness, moral conduct, and loyalty.

- Assign proper authority and responsibility – In addition to hiring qualified, ethical employees, it is important to place these individuals in situations where they are able to thrive without resorting to unethical conduct. Organizations should provide employees with well-defined job descriptions and performance goals. Performance goals should be routinely reviewed to ensure that they do not set unrealistic standards. Training should be provided on a consistent basis to ensure that employees maintain the skills to perform effectively. Regular training on ethics will also help employees identify potential trouble spots and avoid getting caught in compromising situations. Finally, management should quickly determine where deficiencies in an employee's conduct exist and work with the employee to fix the problem.

- Mandate fraud and ethics training for staff – It must be mandatory for all employees (including upper-level personnel) to receive fraud prevention and detection training. This training should cover the company's stance on corporate compliance: its code of ethical conduct, the company's procedures and standards, as well as employees' roles and responsibilities to report misconduct in the organization. It should also inform employees about what kinds of acts and omissions are prohibited by law and by the organization to help them avoid situations that could lead to criminal conduct. New employees must be required to attend this training. The company should provide on-going and continuing training for all employees. These training sessions should be used as a tool to communicate and reinforce the organization's values, code of conduct, and expectations. Common training techniques include lectures, training films, and interactive workshops. Compliance standards should be regularly emphasized.

- Implement effective disciplinary measures – No control environment will be effective unless there is consistent discipline for ethical violations. Consistent discipline requires a well-defined set of sanctions for violations and strict adherence to the prescribed disciplinary measures. If one employee is punished for an act and another employee is not punished for a similar act, the moral force of the company's ethics policy will be diminished. The levels of discipline must be sufficient to deter violations. It may also be advisable to reward ethical conduct. This will reinforce the importance of organizational ethics in the eyes of employees.

- Implement a confidential hotline – Hotlines have proved to be a very effective reporting mechanism. According to the ACFE's 2006 *Report to the Nation on Occupational Fraud and Abuse*, occupational frauds were more likely to be detected by a tip than by any other means such as internal audits, external audits, or internal controls. Additionally, organizations with hotlines had a median loss of $100,000 per scheme and detected their frauds within 15 months of inception. By contrast, organizations without hotlines suffered twice the median loss ($200,000) and took 24 months to detect their frauds.

The mere mention of an anti-fraud, confidential hotline can deter fraud. When employees are aware of workplace ethics, their likelihood of engaging in misconduct decreases, according to the NBES survey. An organization can place an advertisement in the staff break room with a hotline number that employees can call to confidentially report suspicious fraudulent activity in the workplace. Promoting anti-fraud hotline numbers will send the message that the company is encouraging an ethical environment by allowing employees to fearlessly report misconduct.

- Establish a whistleblower policy – Companies should establish and communicate a whistleblower protection policy to allow employees to come forward and report misconduct in the workplace. This policy should allow employees to report or seek guidance regarding actual or potential criminal conduct by others within the organization while retaining anonymity or confidentiality, without fear of retaliation. Additionally, in many organizations, whistleblowers may be protected by state and federal law. Therefore, you should consult with your legal counsel to train and educate employees about whistleblower protections.

  Here are the ways to create a robust and successful whistleblower program:

  - ✓ Implement a 24/7 hotline staffed with trained interviewers;
  - ✓ Nurture ongoing dialogue by assigning a unique identification number to an anonymous caller, so he or she can call back to respond to questions; and
  - ✓ Protect confidentiality by not using caller ID, e-mail tracking, or other means of tracking communication

  Remember that the anti-fraud hotline should protect an employee's identity. Any posters or company communications that promote the anti-fraud hotline should emphasize clearly that reports and employee identities will remain confidential. Employees should be well aware of the fact that they will remain anonymous if they call an anti-fraud hotline. Those who are on the other end of the line, taking these anti-fraud reports, should fully understand the significance of keeping the whistleblower's identity completely confidential, as well as the details of the investigation.

- Follow through with reports of misconduct and promote effective internal controls – Organizations must have a standard procedure for dealing with fraud allegations. The management team must conduct a full-fledged investigation when misconduct is reported. After an offense has been detected, the organization must have taken all reasonable steps to respond appropriately and to prevent further similar offenses – including any necessary modifications to its program to prevent and detect violations of the law. Those at the top of the organization are responsible for clearly stating and upholding the message that all employees will be required to act within the company's ethical code of conduct. This message *must* be enforced in order to prevent and deter fraud in the organization.

- Prevent reprisals – The organization should make every effort to protect the identity of and prevent reprisals against whistleblowers.

- **Create a culture of doing the right thing** – By implementing all of the above steps, and making sure that everyone in the organization (especially those at the top) are actively maintaining corporate standards, a culture of "doing the right thing" will be created. This is the ultimate goal that should *always* be the striving point.

Anti-fraud processes and controls

It is recommended that management obtain a copy of the AICPA's report, "Management Antifraud Programs and Controls: Guidance to Help Prevent and Deter Fraud," which is a report commissioned by the Fraud Task Force of the AICPA's Auditing Standards Board. It is an extremely valuable reference and can be obtained from the AICPA's website: www.aicpa.org. The report provides a number of recommendations for strengthening an organization's anti-fraud programs, including the following:

Evaluating Antifraud Processes and Controls

- **Identifying and Measuring Fraud Risks:** Management has primary responsibility for establishing and monitoring all aspects of the agency's fraud risk-assessment and prevention activities. Fraud risks are often considered as part of an enterprise-wide risk management program, though they may be addressed separately as well. The fraud risk-assessment process should consider agency vulnerabilities and its exposure to material losses, taking into account the agency's size and the complexity of its operations.

- **Mitigating Fraud Risks:** Management should conduct an internal risk assessment to identify and prioritize the different types of fraud risks and apply appropriate fraud mitigation strategies. This process is an essential component of a healthy control environment and can reduce certain fraud risks.

- **Implementing and Monitoring Appropriate Internal Controls:** Most risks can be mitigated with an appropriate system of internal control. Once a fraud risk assessment has been performed, the agency must identify the ongoing processes, controls, and other monitoring procedures that are needed to identify and/or mitigate those risks.

Developing an Appropriate Oversight Process

- **Independent Audit Committee or Board of Directors:** The audit committee (or the board of directors where no audit committee exists) must systematically and periodically evaluate management's identification of fraud risks, the implementation of antifraud prevention and detection measures, and the creation of the appropriate "tone at the top." Active oversight by the audit committee serves as a deterrent to management and employees engaging in fraudulent activity and helps management fulfill its responsibility. Active oversight by the audit committee helps to reinforce management's commitment to creating a culture with "zero tolerance" for fraud.

- **Management:** Fraud prevention and detection requires commitment from both management and the decision makers of the organization. Ideally, managers must be

assigned direct responsibility to develop, implement, and maintain effective fraud prevention measures within their area of expertise.

- Other Oversight Resources: Internal and external auditors and certified fraud examiners can provide expertise, knowledge, experience, and objective, independent input into the agency's fraud risk assessment process. They can assist in developing prevention and mitigation measures and in the resolution of allegations or suspicions of fraud.

Just relying on a formalized Codes of Ethics can be counterproductive in preventing fraud

While it is important to implement a formalized code of ethics in an organization, *just* relying upon these strict codes to detect fraud can be counterproductive. When executives simply hand out a written code of ethics for the employees to comply with, without setting an example as to how to live by and interpret the code, the employees will no longer engage in any kind of moral analysis. Moral analysis is crucial because ethical situations are complex and deserve individual attention that may go beyond the scope of what is written in the code of ethics. If a company becomes too dependent upon a checklist of prohibited actions, employees will begin to lose the ability to analyze each complex ethical situation as it comes up in the workplace. While a formalized code of ethics is a good *starting point,* employers and employees should not solely rely upon a written code. It is impossible to list every ethical situation an employee may face, and an attempt to do so may lead the employee to conclude, "If it's not specifically prohibited by the code of ethics, it must be o.k." There should be room for analysis beyond what is written in the formal document.

Conclusion: Suggestions on how corporate leaders can create and maintain a true ethical climate in their organizations

In summary, there are four steps that an organization's leadership can take to create and maintain a good ethical climate within an organization:

Communicate what is expected of employees:

The first step executives need to take is to state clearly and convincingly what the organization's values and ethics are and the behavior that is expected from each employee. This should be done through the implementation of a written code of ethics and a formal training program. The policy should be continually reinforced through communications from the organization's leaders.

Lead by example:

The second step is to lead with integrity. Employees take their work ethic cues from those at the top of the organization. Executives cannot just *talk* about acting ethically, executives also have to "*walk the walk"* and show employees how to act by setting the example. Management must demonstrate their commitment to ethics through both their words and their actions.

Provide a safe mechanism for reporting violations:

The third step is to create an environment of safety for employees to report misconduct. Those who know about, or are suspicious of, fraudulent behavior or other ethical violations should be able to come forward and report misdeeds without the fear of retaliation from upper level management or their colleagues. Executives need to strongly convey the message that reporting misdeeds is highly-valued by the company and those who do the reporting will be protected to the highest degree.

Reward integrity:
The fourth step is to reward integrity. Companies should not reward employees only for meeting financial goals. If executives see ethical behavior, they should be rewarded for it. Employees should know that meeting the bottom line is not the only measure of success. Acting with integrity and ethics should also be rewarded by the company and should be integrated into existing employee incentive programs to encourage ethical behavior.

Remember, employees look to management for direction. Management must be conscious of the signals it is sends to its employees. Creating an ethical tone at the top will cut losses due to fraud and improve loyalty and morale. Preventing fraud is good business, and it starts at the top.

THE WALL STREET JOURNAL.

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Once Seen as Risky, One Group Of Doctors Changes Its Ways

Anesthesiologists Now Offer Model of How to Improve Safety, Lower Premiums

By
JOSEPH T. HALLINAN Staff Reporter of THE WALL STREET JOURNAL
Updated June 21, 2005 12:01 a.m. ET

The rising cost of medical-malpractice insurance has hit many doctors, especially surgeons and obstetricians. But one specialty has largely shielded itself:

Anesthesiologists pay less for malpractice insurance today, in constant dollars, than they did 20 years ago. That's mainly because some anesthesiologists chose a path many doctors in other specialties did not. Rather than pushing for laws that would protect them against patient lawsuits, these anesthesiologists focused on improving patient safety. Their theory: Less harm to patients would mean fewer lawsuits.

Over the past two decades, anesthesiologists have advocated the use of devices that alert doctors to potentially fatal problems in the operating room. They have helped develop computerized mannequins that simulate real-life surgical crises. And they have pressed for procedures that protect unconscious patients from potential carbon-monoxide poisoning.

All this has helped save lives. Over the past two decades, patient deaths due to anesthesia have declined to one death per 200,000 to 300,000 cases from one for every 5,000 cases, according to studies compiled by the Institute of Medicine, an arm of the National Academies, a leading scientific advisory body.

Malpractice payments involving the nation's 30,000 anesthesiologists are down, too, and anesthesiologists typically pay some of the smallest malpractice premiums around. That's a huge change from when they were considered among the riskiest doctors to insure. Nationwide, the average annual premium for anesthesiologists is less than $21,000, according to a survey by the American Society of Anesthesiologists. An obstetrician might pay 10 times that amount, Medical Liability Monitor, an industry newsletter, reports.

In some areas, anesthesiologists can now buy malpractice insurance for as little as $4,300 a year, although premiums ranged as high as more than $56,000, according to the ASA. The ASA survey gave no general explanation for the disparity but did note that premiums were higher for anesthesiologists who had been sued before and for those who perform higher-risk procedures.

A 1999 report by the Institute of Medicine noted that "few professional societies or groups have demonstrated a visible commitment to reducing errors in health care and improving patient safety." It identified one exception: anesthesiologists.

"If there were any specialty where you said, 'Show me who has done anything right,' I would point to the anesthesiologists," says Neil Kochenour, medical director at the University of Utah Hospitals and Clinics. "They have really made some inroads and some impact."

Medical errors are a leading cause of death in the U.S., killing between 44,000 and 98,000 Americans each year, according to various studies.

Medical-malpractice insurance rates for some specialties, such as obstetrics and general surgery, have risen in some areas, especially in the past few years, as insurers have reported higher paid losses. The insurance industry and many doctors groups have blamed greedy plaintiffs lawyers and capricious juries for those losses. As a remedy, insurers and many medical organizations have pushed for legislation that caps damage awards and lawyers' fees. Most states have enacted some form of tort reform.

Many anesthesiologists also support legislative moves to rein in malpractice suits. "Even though we've controlled costs, it's still a big issue for our membership," says Karen B. Domino, chair of the ASA's committee on professional liability.

But overall, anesthesiologists have put more emphasis on improving safety. And

now, some doctors in other fields are praising them for choosing a different response. Noting the success achieved by anesthesiologists, other doctors -- notably surgeons -- have aimed more at improving treatment methods. "There's a lot of room for us to do a better job and decrease liability, not just for patient safety but to reduce liability [premiums]," says F. Dean Griffen, a surgeon in Shreveport, La., who heads the patient-safety and professional-liability committee for the American College of Surgeons. That professional group recently launched a study of cases modeled on one that helped anesthesiologists recognize some of their shortcomings years ago.

For most of its 160-year history, anesthesiology, the practice of rendering a patient unconscious or insensitive to pain, has been fraught with danger. As recently as 30 years ago, doctors in the U.S. still made patients unconscious by administering ether and other flammable gasses. On rare occasions, static electricity sparked explosions. Less rarely, patients asphyxiated during surgery because their breathing tubes mistakenly became disconnected.

In 1982, the ABC news program "20/20" aired a piece on anesthesia-related deaths. "It was a devastating indictment of anesthesia," recalls Ellison C. Pierce Jr., a retired professor of anesthesiology at Harvard Medical School who is considered by many to be the father of the modern anesthesia-safety movement.

Around the same time, anesthesiologists were getting hit by their second wave of big malpractice-insurance premium increases in a decade. The specialty was then considered among the riskiest to insure, and premiums were often two to three times as high as those other doctors paid. Casey Blitt, a 63-year-old Tucson, Ariz., anesthesiologist who has long been active on patient-safety issues, says his insurance soared to $50,000 a year from $20,000 or less. Dr. Pierce says anesthesiologists were "terrified," and anxious to do something.

Dr. Pierce at the time was president of the American Society of Anesthesiologists. In 1985, that group provided $100,000 to launch the Anesthesia Patient Safety Foundation. The new foundation was unusual in medicine: a stand-alone organization solely devoted to patient safety. Working closely with the larger ASA, from which it still receives about $400,000 a year, the foundation galvanized safety research and improvement.

Unlike most other medical groups, the foundation admitted as members not only doctors but nurses, insurers and even companies that make products used by anesthesiologists. Industry's participation initially caused angst over whether the foundation was designed merely to sell machines. But over the years, that

concern dissipated, Dr. Pierce says, as company money helped the organization fund important research.

One advance was the development of high-tech mannequins that allow anesthesiologists to practice responses to allergic reactions and other life-threatening situations. Anesthesiologists say the mannequins have also allowed them to become more proficient at performing an emergency procedure akin to a tracheotomy that involves slitting open a clogged airway -- something a doctor can't practice on live patients.

Twenty years ago, little was known about people injured or killed during anesthesia. No U.S. database existed, so anesthesiologists set out to create one. They decided to collect information from insurers on closed malpractice claims, those in which insurers had made a payment or otherwise disposed of the complaint.

Most insurers hesitated to cooperate at first, saying they were worried about patient privacy. One company finally agreed: St. Paul Fire & Marine Insurance Co. in Minnesota said it was concerned about heavy losses it had suffered from anesthesia-related injuries and was eager for anesthesiologists to review claims. Soon, other insurers followed suit.

Anesthesiologists left their practices for days at a time to pore over closed insurance claims. The information they collected was fed into a computer at the University of Washington to create an overall picture of how anesthesia accidents tend to occur. It "was a humbling experience," recalls Russell T. Wall, an anesthesiology professor at Georgetown University School of Medicine in Washington, D.C. To date, more than 6,400 claims have been analyzed.

In part by analyzing claims, the anesthesiologists were able to document the extent to which patients were dying because of a simple mistake: Anesthesiologists were inserting the patient's breathing tube down the wrong pipe. Rather than putting it down the trachea, which leads to the lungs, they were accidentally inserting it down the esophagus, which leads to the stomach. The problem was, there was no way to determine quickly whether the tube was in the right pipe. Patients often simply turned blue or their blood turned dark. By then, it was usually too late to save them.

The research contributed to two innovations that between them would all but eliminate death and injury from "intubation" errors. One, known as pulse

oximetry, measures the oxygen level in the patient's blood stream by means of a device that clips onto the patient's finger. The other, capnography, measures carbon dioxide in a patient's expelled breath, which helps doctors determine at a glance that a patient is breathing properly.

At the time, though, the new technologies had a drawback, Dr. Pierce says: "It was very hard to get hospitals to buy pulse oximeters and capnographs," he says. When they were introduced in the 1980s, the two devices together cost about $10,000, according to several anesthesiologists.

That's where the safety foundation came in. In 1986, at the urging of the foundation, anesthesiologists made the use of pulse oximetry part of the ASA's basic standards for anesthesia care. A bit later, they added capnography.

Failing to adhere to ASA recommendations can expose hospitals to malpractice liability. By 1990, says Dr. Pierce, almost all American hospitals had pulse oximeters and capnographs.

That change has been accompanied by other less obvious improvements. During surgery, a patient's body temperature can fall as room-temperature intravenous fluids are infused into the blood. This cooling can cause tissue to die and make the body vulnerable to infection. The safety foundation funded research on the problem in the 1990s, and now care is taken to keep patients warm during surgery, often with specially made blankets that can be heated. Blood and fluid warmers are also used.

Anesthesiologists also have become much better at preventing patient exposure to carbon monoxide. The potentially deadly gas can be an unintended byproduct of the process of cleansing a patient's exhaled breath of carbon dioxide before the air is recycled back to the patient's lungs. One simple way to guard against this problem is to make sure that absorbent material in anesthesia machines that filters the recycled air remains moist.

In 1994, the newsletter of the anesthesiologists foundation documented cases in which patients were exposed to high levels of carbon monoxide during surgery on Mondays, presumably after absorbents had spent the weekend drying out. The organization recommended replacing the absorbent material on Monday mornings and several other changes. These are now standard practice, and rates of carbon-monoxide exposure have fallen dramatically.

Anesthesiologists are now focused on alarm bells. Modern anesthesia machines come equipped with audible alarms that sound when certain thresholds, such as oxygen levels, are crossed. But the alarms irritate many surgeons, so some anesthesiologists have turned them off. The foundation has documented 26 alarm-related malpractice claims between 1970 and 2002, or a little more than one a year. Of those, more than 20 resulted in either death or brain damage.

The foundation is pushing to adopt a formal standard that prohibits anesthesiologists from disabling the alarms. "I would not fly on an airplane if the pilot announced all the alarms were being turned off," says Robert K. Stoelting, the foundation's current president. "Our patients deserve the same safety net."

Dr. Stoelting, a retired chair of the anesthesiology department at the Indiana University School of Medicine, runs the foundation from suburban Indianapolis. He has a two-person administrative staff and a relatively modest $1 million annual budget.

As anesthesia fatalities have dropped, so has the percentage of total malpractice suits filed against anesthesiologists. In 1972, according to a recent study by Public Citizen, a consumer-advocacy group in Washington, D.C., anesthesiologists accounted for 7.9% of all medical-malpractice claims, double the proportion of physicians who practiced anesthesiology. Between 1985 and 2001, anesthesiologists accounted for only 3.8% of all claims, roughly comparable to the percentage of doctors who were anesthesiologists.

The size of payments from successful malpractice suits against anesthesiologists also has declined. According to the American Society of Anesthesiologists, the median payment during the 1970s was $332,280. By the 1990s, it had dropped 46%, to $179,010. These amounts are in 2005 dollars and are the most recent figures available.

Claims for serious injuries have become less frequent. In the 1970s, according to the ASA, more than half of anesthesia-malpractice claims involved death or permanent brain injury. In the 1990s, that fell to less than one-third of claims.

Malpractice rates for anesthesiologists have gradually fallen, the ASA says. This year, the average annual premium is $20,572, compared with $32,620 in inflation-adjusted dollars in 1985. That's a decrease of 37% over 20 years. Malpractice rates are generally set at the beginning of the year.

Anesthesiologists still make mistakes and aren't immune to recent moves in

insurance rates. Their annual inflation-adjusted premiums have climbed 24% since 2002, when they had dipped to an average of $16,559. Insurers say that overall malpractice rates have risen by that amount or more for other specialties during the same period, but reliable nationwide figures aren't publicly available. As is done in other specialties, anesthesiologists accused of disciplinary problems are referred to state licensing agencies.

Other specialties have noticed how the anesthesiologists have fared. Dr. Griffen of the College of Surgeons says that more surgeons have begun to see a connection between improving patient safety and lowering malpractice premiums. The college's closed-claims study so far involves about 350 cases, and the group hopes it will grow to 500 this year.

At the University of Utah Hospitals and Clinics, Dr. Kochenour says his institution has tried to emulate the anesthesiologists by concentrating more on identifying systemic errors and less on individual blame. But these efforts run headlong into thinking drummed into physicians since medical school, he says. "I don't think physicians are very good systems thinkers, by and large," he says. Many, especially surgeons, prize their independence, he says, and that makes it hard to achieve the kind of cooperation necessary to reduce errors.

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Press Release

Monsanto Paying $80 Million Penalty for Accounting Violations

FOR IMMEDIATE RELEASE
2016-25

Washington D.C., Feb. 9, 2016 — The Securities and Exchange Commission today announced that St. Louis-based agribusiness Monsanto Company agreed to pay an $80 million penalty and retain an independent compliance consultant to settle charges that it violated accounting rules and misstated company earnings as it pertained to its flagship product Roundup. Three accounting and sales executives also agreed to pay penalties to settle charges against them.

An SEC investigation found that Monsanto had insufficient internal accounting controls to properly account for millions of dollars in rebates offered to retailers and distributers of Roundup after generic competition had undercut Monsanto's prices and resulted in a significant loss of market share for the company. Monsanto booked substantial amounts of revenue resulting from sales incentivized by the rebate programs, but failed to recognize all of the related program costs at the same time. Therefore, Monsanto materially misstated its consolidated earnings in corporate filings during a three-year period.

"Financial reporting and disclosure cases continue to be a high priority for the Commission and these charges show that corporations must be truthful in their earnings releases to investors and have sufficient internal accounting controls in place to prevent misleading statements," said SEC Chair Mary Jo White. "This type of conduct, which fails to recognize expenses associated with rebates for a flagship product in the period in which they occurred, is the latest page from a well-worn playbook of accounting misstatements."

Andrew J. Ceresney, Director of the SEC's Division of Enforcement, added, "Improper revenue and expense recognition practices that obscure a company's true financial results have long been a focus of the Commission. We are committed to vigorously pursuing and punishing corporate executives and other individuals whose actions contribute to the filing of inaccurate financial statements and other securities law violations."

According to the SEC's order instituting a settled administrative proceeding against Monsanto, accounting executives Sara M. Brunnquell and Anthony P. Hartke, and then-sales executive Jonathan W. Nienas:

- Monsanto's sales force began telling U.S. retailers in 2009 that if they "maximized" their Roundup purchases in the fourth quarter they could participate in a new rebate program in 2010.

- Hartke developed and Brunnquell approved talking points for Monsanto's sales force to use when encouraging retailers to take advantage of the new rebate program and purchase significant amounts of Roundup in the fourth quarter of the company's 2009 fiscal year. Approximately one-third of its U.S. sales of Roundup for the year occurred during that quarter.

- Brunnquell and Hartke, both certified public accountants, knew or should have known that the sales force used this new rebate program to incentivize sales in 2009 and Generally Accepted Accounting Principles (GAAP) required the company to record in 2009 a portion of Monsanto's costs

related to the rebate program. But Monsanto improperly delayed recording these costs until 2010.

· Monsanto also offered rebates to distributors who met agreed-upon volume targets. However, late in the fiscal year, Monsanto reversed approximately $57.3 million of rebate costs that had been accrued under these agreements because certain distributors did not achieve their volume targets (at the urging of Monsanto).

· Monsanto then created a new rebate program to allow distributors to "earn back" the rebates they failed to attain in 2009 by meeting new targets in 2010.

· Under this new program, Monsanto paid $44.5 million in rebates to its two largest distributors as part of side agreements arranged by Nienas, in which they were promised late in fiscal year 2009 that they would be paid the maximum rebate amounts regardless of target performance.

· Because the side agreements were reached in 2009, Monsanto was required under GAAP to record these rebates in 2009. But the company improperly deferred recording the rebate costs until 2010.

· Monsanto repeated the program the following year and improperly accounted for $48 million in rebate costs in 2011 that should have been recorded in 2010.

· Monsanto also improperly accounted for more than $56 million in rebates in 2010 and 2011 in Canada, France, and Germany. They were booked as selling, general, and administrative (SG&A) expenses rather than rebates, which boosted gross profits from Roundup in those countries.

Scott W. Friestad, Associate Director in the SEC's Division of Enforcement, said, "Monsanto devised rebate programs that elevated form over substance, which led to the booking of substantial amounts of revenue without the recognition of associated costs. Public companies need to have robust systems in place to ensure that all of their transactions are recognized in the correct reporting period."

Monsanto consented to the SEC's order without admitting or denying the findings that it violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933, the reporting provisions of Section 13(a) of the Securities Exchange Act of 1934 and underlying rules 12b-20, 13a-1, 13a-11, and 13a-13; the books-and-records provisions of Exchange Act Section 13(b)(2)(A); and the internal accounting control provisions of Exchange Act Section 13(b)(2)(B).

Brunnquell, Hartke, and Nienas also consented to the order without admitting or denying the findings that they violated Rule 13b2-1 and caused Monsanto's violations of various provisions. Nienas also was found to have violated Exchange Act Section 13(b)(5). Brunnquell, Nienas, and Hartke must pay penalties of $55,000, $50,000, and $30,000 respectively, and Brunnquell and Hartke agreed to be suspended from appearing and practicing before the SEC as an accountant, which includes not participating in the financial reporting or audits of public companies. The SEC's order permits Brunnquell to apply for reinstatement after two years, and Hartke is permitted to apply for reinstatement after one year.

The SEC's investigation found no personal misconduct by Monsanto CEO Hugh Grant and former CFO Carl Casale, who reimbursed the company $3,165,852 and $728,843, respectively, for cash bonuses and certain stock awards they received during the period when the company committed accounting violations. Therefore, it wasn't necessary for the SEC to pursue a clawback action under Section 304 of the Sarbanes-Oxley Act.

The SEC's investigation was conducted by Antony Richard Petrilla, Darren E. Long, and Paul C. Gunson with assistance from Duane Thompson, Dwayne Brown, and Jan Folena. The investigation was supervised by Brian O. Quinn.

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Related Materials

- SEC order

Press Release

SEC Charges Biopesticide Company and Former Executive With Accounting Fraud

FOR IMMEDIATE RELEASE
2016-32

Washington D.C., Feb. 17, 2016 — The Securities and Exchange Commission today charged biopesticide company Marrone Bio Innovations and a former executive with inflating financial results to meet projections it would double revenues in its first year as a public company. Marrone Bio agreed to pay a $1.75 million penalty to settle the SEC's charges.

The SEC alleges that former chief operating officer Hector M. Absi Jr. concealed from Marrone Bio's finance personnel and independent auditor various sales concessions offered to customers, leading the Davis, Calif.-based company to improperly recognize revenue on sales. Absi allegedly profited from the fraud. He resigned in August 2014 shortly before the alleged fraud came to light and the company's stock price plunged more than 44 percent.

In a parallel action, the U.S Attorney's Office for the Eastern District of California today announced criminal charges against Absi.

"We allege that Marrone Bio misled investors to make itself look like a fast-growing new public company," said Jina L. Choi, Director of the SEC's San Francisco Regional Office. "Public companies and their officers should know better that taking shortcuts to recognize revenue in the near term is harmful to investors and can be damaging to a company's long-term success."

According to the SEC's complaint filed in U.S District Court for the Eastern District of California:

- In November 2015, Marrone Bio restated its results for fiscal 2013 and the first half of fiscal 2014, reversing approximately $2 million of previously reported revenue.
- Absi previously inflated Marrone Bio's revenues by offering distributors "inventory protection," a concession that allowed distributors to return unsold product.
- Absi also inflated Marrone Bio's revenue by directing his subordinates to obtain false sales and shipping documents and intentionally ship the wrong product to book sales.
- Absi abused Marrone Bio's expense reporting system to pay for personal items, including vacations, home furnishings, and professionally installed Christmas lights for his home. Absi falsified his bank and credit card statements to make it appear as though he had incurred the expenses for legitimate business purposes.
- Absi personally profited from his scheme, receiving more than $350,000 in bonuses, stock sale proceeds, and illegitimate expense reimbursements.

The SEC also instituted a settled administrative proceeding against Marrone Bio's former customer relations manager Julieta Favela Barcenas for violations of the books and records provisions of the federal

securities laws. Favela entered into a cooperation agreement to assist in the SEC's investigation and ongoing litigation against Absi.

As required by Section 304(a) of the Sarbanes-Oxley Act, Marrone Bio CEO Pamela G. Marrone has reimbursed the company $15,234 and former CFO Donald J. Glidewell will reimburse the company $11,789 for incentive-based compensation they received following the filing of Marrone Bio's misstated financial statements. They weren't charged with any misconduct.

The SEC's investigation was conducted by Joseph P. Ceglio and John A. Roscigno and supervised by Tracy L. Davis, and the litigation is being led by Robert L. Tashjian and Jason M. Habermeyer of the San Francisco office. The SEC appreciates the assistance of the U.S. Attorney's Office for the Eastern District of California and the Federal Bureau of Investigation.

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Related Materials

- SEC complaint - Marrone Bio
- SEC complaint - Absi
- SEC order - Barcenas
- SEC order - Glidewell

International Health Care Enforcement

THE DIRECTORS ROUNDTABLE
OCTOBER 6, 2016

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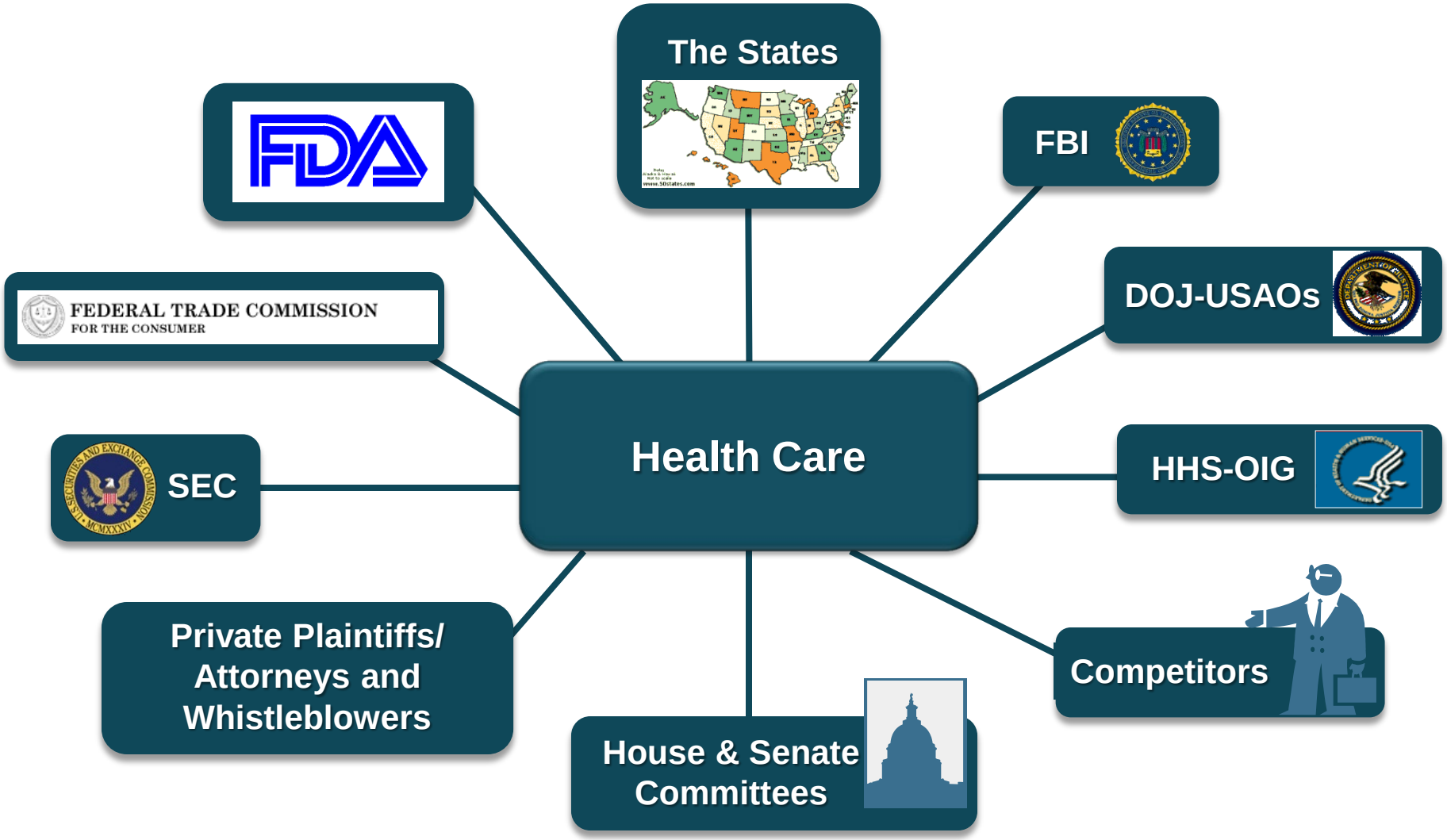
General Enforcement Trends

- U.S. Government continues to focus on health care fraud enforcement
  - "Qui tam" relator incentives under the False Claims Act
  - $16.5B in health care fraud recoveries between January 2009 and September 2015

- Anti-corruption enforcement continues to focus on the health care industry

- Expansion of enforcers increases complexity, duration, and cost of investigations

The U.S. Enforcers



Foreign Corrupt Practices Act Developments

- Vigorous DOJ/SEC enforcement
- Aggressive extraterritorial enforcement by DOJ and SEC
- Geographic focus has been in China, Eastern Europe, and Latin America
- Heightened expectations for compliance programs with DOJ compliance consultant

2015 DOJ Yates Memorandum

- Greater emphasis on prosecuting individuals
- Potential for more parallel criminal and civil fraud cases
- DOJ has stressed that the memo applies with equal force to civil investigations, and specifically False Claims Act investigations
- Greater cooperation credit for corporate defendants?
- Challenges for General Counsel

Ex-U.S. Enforcement

- Greater cooperation between global regulatory and enforcement authorities
- U.K. Serious Fraud Office
- Selected Chinese enforcers
- Selected European enforcers (e.g., Germany, Romania)
- Follow-on investigations from US settlements

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January 2014

Technology Media and Telecommunications.

EU - Coordinated enforcement action over Google's 'new' privacy policy

Google issued its new privacy policy in March 2012 to simplify and consolidate its numerous existing policies. However, it provoked a fierce reaction from European privacy regulators, not least because the policy allows greater sharing of user data across Google's different services. After a prolonged investigation, six regulators have taken coordinated enforcement action against Google. We provide an overview of that action and consider the wider privacy implications.

The 'new' privacy policy

Since its incorporation in 1998, Google has grown significantly, developing or acquiring numerous services along the way, including Google Maps, Gmail and YouTube. It has been particularly successful in Europe where its market share in web search is well above 90%. Its services have tended to have their own privacy policies, however, leading to 60+ privacy policies at one point.

Google therefore set out to simplify and consolidate these policies, whilst at the same time allowing information about users who have signed into Google services to be shared and providing a "simpler, more intuitive Google experience". Recognising this would be a significant change affecting a large number of people, Google added a prominent notice on many of its web pages about this change.

The new policy runs to nearly 2,300 words and sets out in broad terms what information Google collects, how it is used and what choices users have about the use of that information. Whilst it is clearly intended to be as user-friendly as possible and is written in (relatively) plain English, it has been subjected to a range of criticisms.

Regulators investigate

The new policy provoked a swift response from regulators. Prior to the change taking place, the Article 29 Working Party (a representative body of European data protection regulators) appointed the French data protection authority (the "**CNIL**") to lead an investigation into these changes.

Contents

The CNIL issued Google with a detailed list of questions and asked that the changes to the privacy policy be suspended until that investigation was complete. Google refused, arguing that it had made strenuous efforts to discuss the policy well in advance of its launch and to suspend it now was unfair. Google's new privacy policy went live as scheduled at the start of March 2012.

Findings and recommendations

The CNIL completed its investigation in October 2012 and issued its findings and recommendations. In broad terms, it identified three categories of individuals who use Google's services:

> *authenticated users* – these are users who have created an account with Google in order to receive services such as Gmail or Google Apps. Google is likely to obtain more information about those users but equally has greater opportunity to notify and obtain their consent to that use;

> *non-authenticated users* – these are users who use Google services, such as Search or Maps, without a Google account; and

> *passive users* – these are users who do not directly use Google's services but whose personal data is captured by Google from third-party websites, for example because of third-party cookies placed on their computer by Google's DoubleClick or Analytics businesses.

The investigation found a number of breaches of European data protection laws. In summary:

> *lack of information* – the new privacy policy did not provide enough information about what personal information was being collected and how it was being used. For example, the policy specified a number of vague purposes such as "*improving user's experience*". Nor was it clear how it used "the innocuous content of search queries" differently from more intrusive types of data such as credit card details or data on telephone communications; no distinctions were drawn. Finally, some types of data (the +1 button for example) weren't explained at all. Essentially, Google got the balance between simplifying the policy and providing comprehensive information to users wrong.

> *improper combination of data across services* – Google could not justify its processing of personal data. The CNIL focused on the combination of data about users from different services. This did not satisfy a statutory processing condition. In particular: (i) the privacy policy is too vague to form the basis of a specific and informed consent from users; (ii) in the majority of cases the processing was not necessary for a contract with the individual; and (iii) the extensive nature of the data collected by Google meant it cannot rely on the legitimate interests test (see art. 7(a), (b) and (f) respectively). The investigation also considered a number of other processing activities carried out by Google under the new privacy policy. The CNIL decided

that some were justified (such as security and academic research) but others were not as they required unambiguous consent (such as personalisation, product development, advertising and analytics);

> *use of cookies without consent* – Google's use of DoubleClick and Analytics cookies was in breach of art. 5(3) of the ePrivacy Directive as it failed to obtain informed consent to their use. This is a particular issue for passive users; and

> *retention period* – despite "numerous and detailed" questions, Google failed to clearly explain how long it retained copies of users' information.

The CNIL report made a range of recommendations to address these issues. For example, Google should improve the information its provides to users through the use of three tiered layered privacy notices (as recommended by the Berlin Group of data protection authorities over nine years ago), product-specific privacy notices and "interactive presentations". Google should also take a number of steps to legitimise its processing, including limiting the circumstances in which data is combined, simplifying opt-out mechanisms and making it easier for authenticated users to use Google's services on a non-authenticated basis.

The CNIL suggested greater protection for passive users and recommended Google take greater steps to inform them of any processing and limit the information collected about them.

National enforcement action

Google was asked to implement these recommendations by February 2013 but failed to do so. As a result, the CNIL established a working group of national data protection authorities to take coordinated enforcement action. In April 2013, it was announced that enforcement action would be taken by the French, German, Italian, Dutch, Spanish and United Kingdom data protection authorities. A brief overview of this enforcement action is set out below.

France – The CNIL fined Google €150,000 on 3 January 2014. This is the highest fine available. The fine was largely based on the breaches found by the CNIL in its earlier investigation in October 2012. The CNIL also ordered Google to publish an announcement about this sanction on its French website www.google.fr for 48 hours, indicating that Google was fined €150,000 for breach of data privacy rules and providing a link to the CNIL decision. Google has filed an appeal before the highest administrative Court (*Conseil d'Etat*). Should this appeal be rejected, Google will have to amend its privacy policy and practices or face further fines (which will double to €300,000 as it will be a repeat offence) and an injunction to prevent further processing.

Germany – In July 2013 the Hamburg DPA initiated administrative proceedings against Google Inc. challenging Google's privacy policies. Google was asked to present its case by mid-August 2013. Recently, the Hamburg DPA proclaimed that the information Google provided is currently

under examination in order to decide whether further steps against Google will be initiated.

Italy – The Italian data protection authority (*Garante per la protezione dei dati personali*) issued a press release on 20 June 2013 indicating it was seeking further information from Google about the processing of data of Italian users, particularly its use of privacy notices, the manner in which user consent is obtained, the storage of data and their combined use among different products and services. In a separate interview the Chairman of the Garante suggested that it wanted a response by 30 June 2013 and should Google fail to respond, the Garante "*will open a procedure that may lead to a sanction in the range of millions of Euro. Money is not a problem for Google, in fact the real sanction would be the loss of trust by consumers. Injuring privacy rights means limiting freedom for all*".

Netherlands – In November 2013, the Dutch data protection authority (*College bescherming persoonsgegevens*) issued detailed findings following its investigation into Google's new privacy policy. Those findings are broadly similar to those in the CNIL's earlier investigation in October 2012. The chairman of the Dutch data protection authority, Jacob Kohnstamm, stated that "*Google spins an invisible web of our personal data, without our consent. And that is forbidden by law*" and has invited Google to attend a hearing, after which it may take formal enforcement action such as an injunction to prevent further processing subject to periodical fines for failure to comply. The Dutch data protection authority can only impose relatively small fines itself. Criminal enforcement could lead to fines of up to €78,000, and even six months' imprisonment, but is unlikely in this case.

Spain – The Spanish Data Protection Authority (*Agencia Española de Protección de Datos*) has taken the strongest action. In December 2013, the AEPD found that Google does not give users enough information about what data they collect and for what purposes it uses them, that Google combines those data gathered through various services, keeps them for an indefinite time and makes it difficult for citizens to exercise their rights. Therefore, the AEPD found that Google has breached three provisions of the Organic Law 15/1999, of 13 December: (i) article 4.5 regarding the period of retention; (ii) article 6.1 regarding the consent of the data subjects (because of the lack of transparency); and (iii) articles 15 and 16 regarding the rights of citizens (for example, to access and rectify their data). The AEPD imposed a fine of €900,000 (€300,000 for each of the three breaches). It also ordered Google to amend its practices to comply with the law without delay.

United Kingdom - In contrast, the Information Commissioner has only taken limited steps to date. It contacted Google in July 2013 raising "*serious questions*" about the compliance of its new Privacy Policy with the Data Protection Act 1998. The main objection was the lack of information provided to users. Google was given until September 2013 to comply or face "*formal enforcement action*". So far no formal action has been taken. As much as anything this may be a result of the limited remedies available to the Information Commissioner.

Issues for privacy policies

The current enforcement action illustrates some of the problems with privacy policies. The data protection authorities want Google to include a lot more detail and for each service to set out exactly what personal data is collected, how it is used and to whom it is disclosed. In contrast, Google would clearly prefer to provide a simplified privacy policy that only describes at a high level how it uses personal data. This would allow it to innovate and amend its services without necessarily having to reissue its privacy policy each time.

Google's approach may reflect the hard fact that very few users will bother to read its new 2,300-word policy, let alone the more detailed policy envisaged by regulators. However, there are other ways to get your message across. For example, the CNIL's initial investigation in October 2012 made a number of recommendations such as the use of layered privacy notices, in-product privacy reminders and interactive presentations.

The privacy policies ought to also lead on to meaningful choices for users. However, Google's opt-out mechanism was found to be "too complex and ineffective". The CNIL's report suggests that a mobile authenticated Google+ user who does not want personalised ads would have to perform six different opt-outs. Moreover, the operation of some of the opt-out mechanisms is not clear in that they do not prevent the collection of data, but only the display of personalised content.

Jurisdiction questions remain open

The enforcement action is also predicated on the relevant national regulators having jurisdiction over Google. This issue is complicated by the fact that Google's search engine is operated solely by Google Inc., which is based in California. Local jurisdiction would therefore only arise if Google Inc. is established in that jurisdiction by way of a local subsidiary or because Google Inc. is using equipment, i.e. cookies, on users' equipment (see art. 4(1)(a) and (c)).

Establishing jurisdiction through either route is far from certain. Both Google and the national regulators must be eagerly awaiting the CJEU's decision on this issue in *Google v AEPD* (C-131/12). This is perhaps a good example of the justification for an extra-territoriality provision in the proposed General Data Protection Regulation.

Effectiveness of enforcement action

While this enforcement action is notable because of the close co-ordination of data protection authorities in a number of Member States, there is a question about how effective it will be in practice. So far Google has been fined a total of €1,050,000. In purely financial terms, this is around 0.003% of Google's turnover and was described as "pocket money" by Viviane Reding, the European Justice Commissioner. Ms Reding has instead called for fines of up to 2% of annual worldwide turnover in the General Data Protection Regulation (and the Parliament has gone further and called for fines of up to 5% of turnover).

Equally, it is not clear that the national regulators' actions are winning the war of hearts and minds. The single thing most likely to force Google to make significant and sustained changes to its privacy practices would be a migration of its customers to more privacy-friendly alternatives, such as the privacy-friendly search engine ixquick. However, despite fairly vigorous ad campaigns warning of the impact these changes could have on user's privacy (such as the "Every data point" campaign run by Microsoft) Google has held on to market shares in web search well above 90% in most European countries for several years now and there is little to suggest the latest action by regulators will reduce its dominance in the near future.

An extended version of this article appeared in the January 2014 edition of World Data Protection Report. See http://www.bna.com/world-data-protection-p6718/ for further details.

By Richard Cumbley (London), Daniel Pauly (Frankfurt), Paul Kreijger (Amsterdam), Alexandre Entraygues (Paris), Beatriz Pavon (Madrid) and Federica Barbero (Milan)

EU – Proposals for Europe-wide protection of trade secrets

At the end of 2013, the European Commission proposed a new Directive to harmonise the protection of trade secrets. The Directive contains a number of familiar concepts and broadly follows the provisions in the TRIPS Agreement relating to the protection of undisclosed information. We consider why these changes are being proposed and the implications for the IT sector.

Why is reform needed?

Almost all businesses rely on trade secrets, as much they rely on other forms of intellectual property. Trade secrets can be particularly important to small and medium-sized enterprises which lack the specialist resources to obtain and manage registered intellectual property rights. The protection of those trade secrets is also an important part of the European Commission's 2020 strategy to promote research and development investment and make Europe a more rewarding place for innovation.

However, the Commission considers that investment, particularly cross-border investment, is held back by the current diversity and fragmentation in the protection of trade secrets across Europe. Some Member States have specific legislation whereas others rely on general unfair competition or tort law. Some provide very limited protection, such as Malta which primarily relies on contract law. A summary of the position in some key European jurisdictions is set out below.

How will the proposed regime operate?

The proposals broadly follow the provisions in Article 39 of the TRIPS Agreement. The Directive will protect against the unlawful acquisition, use or disclosure of trade secrets, being information that:

> is secret, in that it is not generally known among or readily accessible to relevant persons in the field;

> has commercial value because it is secret; and

> has been subject to reasonable steps to keep it secret.

The acquisition of a trade secret will be unlawful in a range of circumstances including where it is the result of breach of a confidentiality agreement or other practice "*contrary to honest commercial practices*". Equally, the Directive sets out a number of situations in which acquisition will be lawful. Some of these are relatively familiar, such as independent discovery or reverse engineering. However, the Directive also expressly allows acquisition of trade secrets in conformity with "*honest commercial practices*" or, more unusually, as a result of workers' rights to information and consultation.

The Directive also contains a number of general exemptions and permits the acquisition, use or disclosure of a trade secret:

> for making legitimate use of the right to freedom of expression and information;

> where necessary to reveal misconduct, wrongdoing or illegal activity;

> to fulfil a non-contractual obligation; or

> for the "*purpose of protecting a legitimate interest*".

Finally, the Directive includes a minimum set of measures and remedies for trade secret owners. This includes the availability of interim measures, preservation of confidentiality during legal proceedings, injunctions and damages. However, a limitation period will apply and all claims must be brought within 12-24 months (depending on the national implementation of the Directive).

How will these rights interact with confidentiality agreements?

It appears that the new rights under the Directive are intended to co-exist with contractual confidentiality provisions. For example, the recitals expressly state the Directive will not affect the laws of contract.

Confidentiality agreements are likely to continue to be important because they can be used to impose more tightly-defined obligations (for example, avoiding difficult questions about what is an "*honest commercial practice*") and provide a parallel action for breach of contract. This could offer a longer limitation period for bringing claims than the 12-24 month period under the Directive.

Moreover, while a confidentiality agreement will not provide a direct contractual right against a third party who subsequently obtains the information, it may well assist with the enforcement of the trade secret owner's rights against that third party. For example, Directive expressly states that acquisition or use of a trade secret is automatically unlawful if it results from the breach of a confidentiality agreement or similar duty. In other words, the confidentiality agreement may well help define the statutory protection for the relevant trade secret.

What is an "honest commercial practice"?

The acquisition of a trade secret will be lawful if it is in accordance with "*honest commercial practice*". This concept originates from the TRIPS Agreement and, while the answer may be self-evident in many cases, it is easy to envisage more borderline situations.

The courts will have limited guidance in interpreting this term. While it is defined in a footnote in the TRIPS Agreement, the footnote does little to actually clarify its meaning[1]. Moreover, it will be some time before any cases on its meaning come before the CJEU and, even if they do, it may be difficult for the CJEU to make a definitive ruling on what is a very much a question of fact. Finally, the concept of an "*honest commercial practice*" will be new to a number of Member States, so their courts will not be able to rely historic practice.

[1] The footnote states: "For the purpose of this provision, 'a manner contrary to honest commercial practices' shall mean at least practices such as breach of contract, breach of confidence and inducement to breach, and includes the acquisition of undisclosed information by third parties who knew, or were grossly negligent in failing to know, that such practices were involved in the acquisition".

What steps should you take to protect confidential information?

The Directive only protects a trade secret if it is subject to reasonable steps to keep it secret by the person lawfully in control of the information. This concept also originates from the TRIPS Agreement, but will be new in some Member States.

Businesses that rely on trade secrets may want to review the measures they use to protect that information - for example confidentiality agreements with employees and counterparts, protective markings and information security measures. They may also want to document these measures should they be challenged on this point.

What about other confidential information?

The Directive only applies to limited class of confidential information, i.e. information that has "commercial value". Confidentiality laws are drawn more widely in some Member States to protect not only commercial information but also other types of confidential information, including personal information.

Accordingly, the implementation of the law will raise difficult questions in some cases. Should it just cover trade secrets, thus creating a two-tier regime for confidential information? Or is this an opportunity to also "sweep up" other types of confidential information and protect them under a single statutory framework?

Implications for the IT sector and next steps

The proposed Directive does not radically change the protection of trade secrets across the European Union but should help to harmonise their protection, which may well help to foster cross-border investment and innovation. Unfortunately, these changes will not remove the need for confidentiality agreements and it is likely those in the information technology sector will continue to have the joy of negotiating these arrangements as a pre-requisite to the exchange of valuable confidential information.

The Commission's proposals will now be forwarded on to the Council and Parliament for consideration. If the proposals are adopted, Member States will have two years to implement the Directive into national law.

The Commission's proposals are available here.

This article has also been published in Computers & Law. For more details see www.scl.org

By Daniel Pauly (Frankfurt), Pieter Van Den Broecke and Tom de Coster (Brussels), Ewa Kurowska-Tober (Warsaw), Pauline Debré (Paris) and Peter Church (London)

Overview of the current protection of trade secrets in Europe	
Belgium	The proposed Directive would make minor changes in Belgium. There is no single Act for the protection of trade secrets. Trade secret owners can instead rely on general tort and unfair competition law as well as specific provisions in employment and criminal law. The misappropriation, use and disclosure of trade secrets can lead to civil liability under Belgian tort law (Article 1382 of the Belgian Civil Code). It can also be a breach of unfair competition law (Article 95 of the Act of 6 April 2010 on Market Practices and Consumer Protection). Employees and former employees may not disclose any trade secrets belonging to their (former) employer and more generally any secret in respect of a personal or confidential matter of which the employee became aware in the framework of his professional activity (Article 17,3° of the Act of 3 July 1978 on employment agreements). It is possible to file a complaint for disclosure in bad faith of specific technical know-how (so-called "manufacturing secrets") by employees or former employees of a manufacturer (Article 309 of the Belgian Criminal Code). Trade secret violations can lead to civil and criminal remedies including interim measures, compensatory damages, criminal fines and prison sentences. Although the court can take into account any profits made by the infringing party, there exists no separate measure of recovery of profits. Permanent injunctions to prevent further misuse are not easily granted, as most of the courts are reluctant to grant the holder of a trade secret a broader protection (unlimited in time) than most IP right holders (limited in time). In addition, it is not possible to launch a cease-and-desist procedure for breach of contract only. An *ex parte* search and seizure procedure is not available for holders of a trade secret either. Finally, the preservation of trade secrets during court procedures is not certain.
England	The proposed Directive would make a significant change in England in form and, to a lesser extent, substance. There is currently no statutory protection of trade secrets. Trade secrets are instead protected by contract and the laws of equity. Protection under the laws of equity applies to confidential information generally, rather than being limited to trade secrets. It protects information where: (i) it has the necessary quality of confidence; (ii) it was imparted in circumstances importing an obligation of confidence; and (iii) there is unauthorised use of the information to the detriment of the confider.

	Employees are obliged to keep confidential information secret during their employment as a part of their general duty of good faith to their employer. After employment, the employee is only generally prevented from using high-grade confidential information unless further restrictions have been imposed by contract. Breach of confidence gives rise to a range of civil remedies including injunctions to prevent further misuse, compensatory damages and an account of profits. There are no criminal sanctions.
France	The proposed Directive will introduce some minor changes in France and create a single set of rules that will help unify the current legislations on trade secrets. One major change is the limitation period of two years, which is shorter than the current limit of five years. Currently, trade secrets are subject to a patchwork of legislation with the main provisions being found in the Civil code and the Labour code, as well as in the Intellectual Property code. There is no single definition of trade secrets under French law, as various terms coexist such as "*know how*" and "*manufacturing trade secret*". Case law has defined the concept of know-how to be similar to the definition in the proposed Directive. In practice, trade secrets are mainly protected by tort and contract law. The general provisions of the Civil code provide a remedy in tort for a range of abuses including poaching, company disruption and abuse of pre-contractual discussions. Contract law is also widely relied upon and organisations will normally include confidentiality clauses in their employment contracts and sign confidentiality agreements with counterparties. A wide range of remedies are available under French law in case of trade secret violation, including injunctions, return and destruction or seizure of infringing goods, as well as damages. Criminal sanctions may also be imposed, including under French labour law. Finally, a trade secrets bill was proposed in early 2012. This bill contains similar provisions to the TRIPS Agreement and introduces a new offence of violation of "economic information" punishable by up to three years' imprisonment and a maximum fine of EUR 375,000. This bill was approved by the Assemblée Nationale but is currently stuck in the Senate.

Germany	The proposed Directive would lead to some helpful clarifications in German law, but will not make major changes. In particular, the law would need to more clearly define: (i) when trade secrets can be used; and (ii) how trade secrets are to be treated in legal proceedings. The protection of trade secrets is addressed in various areas of German law. The most important statutory provisions are included in the German Act against Unfair Competition and require employees and third parties to treat trade secrets confidentially. In addition, the protection of trade secrets is often covered in contracts, including employment contracts. Pursuant to German case law, a trade secret is any information: (i) in connection with the company; (ii) which is not public and known only to a limited number of persons; (iii) in relation to which the owner of the company has an economic interest to keep such information a secret; and (iv) which is kept a secret by the company owner. According to the German Unfair Competition Law, employees are prohibited from disclosing trade or business secrets learned during the term of the employment to any third party: (i) to compete with the company; (ii) to promote their own interests; (iii) to promote the interest of a third party; or (iv) with the intention of harming the company. After termination of the employment relationship, employees may use any (non-deliberately) memorised information if their personal interest in using such information outweighs the interest of the company in keeping such information a secret. The unauthorised disclosure of trade secrets may trigger civil law liability, including the obligation to compensate for damages, as well as criminal liability.
Poland	The proposed Directive would not make any major changes in Poland, as it is similar to the current protection for trade secrets provided under article 11 of the Act on Counteracting Unfair Competition of 16 April 1993. Under the Act, a trade secret includes technical, technological, commercial or organisational information having a commercial value, not revealed to the public, in relation to which the business entity took necessary steps to maintain its confidentiality. Employees are obliged to take care of their respective place of work, including protecting and maintaining the confidentiality of any information significant to the employer (art. 100 para 2 of the Labour Code). Moreover, arts. 101 and 102 of the Labour Code include non-competition provisions which *inter alia* impose non-compete provisions post-termination for employees

	who have access to particularly important information. Remedies available against trade secret violations have both civil and punitive character, including injunctions to prevent further misuse, compensatory damages and an account of profits. Criminal remedies are also available in certain cases.

Deloitte.

Integration Report 2015
Putting the pieces together

Executive Summary

While the juggernaut of merger and acquisition activity persists—2014 was a strong year with more than 40,000 deals announced[1]—there is no shortage of studies indicating that mergers and acquisitions (M&A) are fraught with challenges and risks. Our 2014 M&A Trends Report[2] revealed expectations that the rapid pace of merger activity would continue. At the same time, that report underscored the persistent challenges in deriving value through the M&A process.

Because the stakes are huge—the aggregate value of the announced 2014 deals approached $3.5 trillion[3]—we began to dig deeper into the challenges and opportunities tied to merger integration. In a new survey on the post-merger phase, Deloitte Integration Report 2015, we asked more than 800 executives to help determine what drives successes, what foils deals, and what companies can do preemptively during the integration period to help increase the likelihood that their deals are the successful ones.

The survey on M&A integration revealed several key points:

- Almost 30 percent of respondents said that their integration fell short of success.
- When asked about synergies, almost 30 percent of respondents indicated that they exceeded synergy targets, while almost one in five (18 percent) said they fell short. An additional 10 percent weren't sure if they met their targets.
- Respondents concurred on the key drivers for successful integration: executive leadership support, involvement of management from both sides, development of a project plan that often included creating a dedicated integration team, and communications.
- Ensuring a smooth transition from beginning of the merger—the day the deal closed and the combined entity became operational—correlated very highly with overall success.

We asked **more than 800 executives** what drives successes, what foils deals, and what companies can do preemptively during the integration period to help increase the likelihood that their deals are the successful ones.

[1] "Deal Makers Notched Nearly $3.5 Trillion Worth in '14, Best in 7 Years," By Michael J. De La Merced, *The New York Times*, January 1, 2015
[2] Deloitte M&A Trends Report 2014, Deloitte LLP, June 2014, www.deloitte.com/us/ma/trends14
[3] "Deal Makers Notched Nearly $3.5 Trillion Worth in '14, Best in 7 Years," By Michael J. De La Merced, *The New York Times*, January 1, 2015

- The inability to deal with unexpected challenges was the primary factor that doomed combinations, with delays and lack of preparedness also being key reasons that some integrations failed.
- In the future, the majority of respondents said they would focus on a swifter and phased integration, better communication, and a more rigorous process to select an integration team. They also said they'd allocate more budget to the integration.

In the pages that follow, we take a look at what our respondents identified as the critical factors for success and what hindered success. We also suggest leading practices gleaned from our experience in dealing with thousands of deals so that you can create an approach to follow to increase the likelihood that your transaction is a winning one.

Tom McGee
Deputy Chief Executive Officer
Deloitte LLP

About the survey

From November 15 to December 18, 2014, a Deloitte survey conducted by OnResearch, a market research firm, polled 803 executives at U.S. companies that had either engaged in a merger or acquisition over the preceding 24 months or were planning one in the next 12 months, or both.

The executives hailed from companies of all sizes, split evenly between the public and private sector. Almost half, 46 percent, had annual revenue of at least $1 billion. Middle-market companies, those with between $100 million and $1 billion in revenue, accounted for 43 percent of total respondents. The rest were smaller businesses. More than 25 percent of respondents worked in the C-suite and an equal number in senior management. About half were middle managers.

The majority of respondents, 60 percent, were involved in domestic M&A transactions. Two of three involved privately held companies. Manufacturers accounted for the largest proportion of all deals (24 percent), though companies in the technology, telecom, media and entertainment sectors each accounted for at least 10 percent of all respondents. Retailers, energy and professional services firms also contributed to the survey.

The average cost of the transactions the respondents were a part of was close to $800 million, with almost one in five eclipsing the $1 billion threshold.

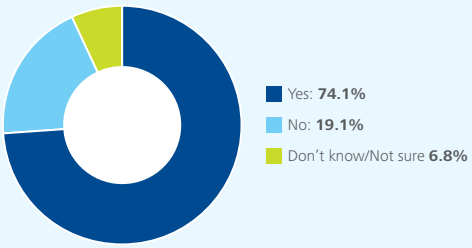
The survey results are included in the appendix; some percentages in the charts throughout this report may not add to 100 percent due to rounding, or for questions where survey participants had the option to choose multiple responses.

Survey findings

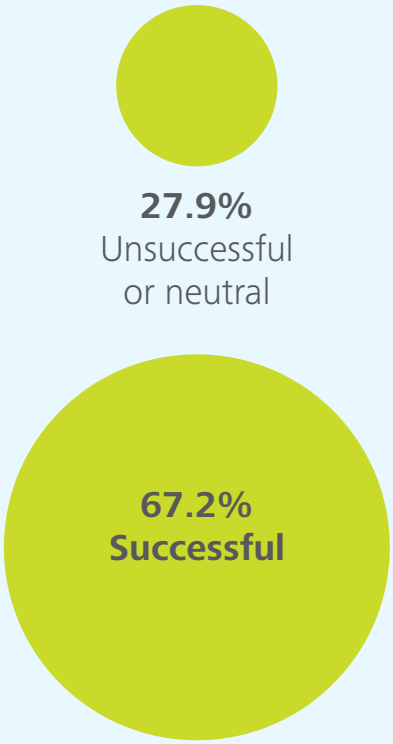
Almost three in four companies (74 percent) said they entered into a merger or acquisition with a formal integration strategy. Just about the exact same number of respondents believed that their strategy clearly aligned with the overall strategy and goals of the transaction. And three-quarters of respondents also said they carefully evaluated their transactions afterwards to see how they fared—whether they worked or didn't.

Almost one-third felt that the deals fell short of meeting expectations. An analysis of the key drivers of success and major challenges provided insight into what made deals succeed and what caused them to stumble.

Was there a formal integration strategy?



How successful do you feel the integration was or has been to date (if your company is still in the integration phase)?



Synergy and Value Capture

One of the key components for helping to determine the success of a transaction is measuring and achieving synergies, according to respondents.

When asked about synergies, 29 percent of respondents said that they exceeded the targets they had established before the transaction. 18 percent indicated that their transaction fell short of achieving their targets, and perhaps worse, 10 percent weren't even sure if they achieved their goals.

"The long-term value derived from a deal hinges mainly on realizing synergies with rare exceptions for competitive purposes," said Joel Schlachtenhaufen, principal, Deloitte Consulting LLP. "All of the elements of a fully integrated company can be in place, but if you haven't achieved the growth and cost synergies you set out to capture, you really haven't succeeded."

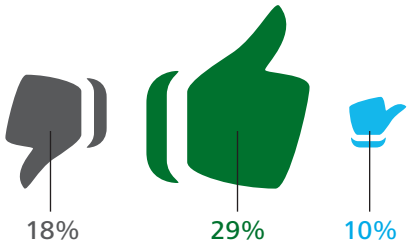
How long did it take to realize synergy targets?

More than half, 52 percent, of the executives estimated that the total benefit from the synergies of the combination were less than half the total deal value. Among those who reported that their synergy target fell short, the estimate by how much they lagged expectations was about 15 percent. Conversely, respondents who said they exceeded anticipated synergy targets, said that they did so by, on average, almost 26 percent.

For an overwhelming number of respondents, almost nine in ten, the integration life-cycle extended no longer than two years. Typically, the need for external partners—who bring experience and can accelerate the value capture efforts and keep the combined company focused and accountable for results—can be greatest during the first three to six months. Then the company enters into the execution phase. About three-quarters of respondents who followed this path said they hit their synergy marks in a year and 43 percent did so in six months.

56 percent of respondents factored tax planning into synergy capture plans.

Almost one in five (18%) companies reported that their **synergy targets** fell short while 29% reported exceeding the initial targets. Meanwhile, 10% weren't sure if they achieved their targets



Readiness

A majority of survey respondents, 72 percent, said that they had a detailed execution plan in place that they put into action on the day that the transaction closed. However, almost one in five, 18 percent, of the M&A executives did not feel that their organization was prepared on the final day of the integration process.

Were there detailed execution plans in place that were put into action on the day the deal legally closed and the new organization became operational?

Yes: **72%** No: **18%**

Information Technology was cited as the functional area in most need of improvement in terms of integration skills and capabilities. Change management, human resources and communications, followed closely.

Next time around, the respondents said they'd focus resources most heavily on accelerating their integration pace; 15 percent ranked that as the most important area they'd focus on. Other critical areas that respondents honed in on included implementing a phased approach to integration, and communicating the strategy to employees, customers, and, to a lesser extent, suppliers, distributors, and other partners.

The majority of companies, 79 percent, said they took steps to internalize lessons learned from their integration experience. The No. 1 most popular lesson learned: re-evaluate integration processes and checklists. Other critical lessons-learned were to provide knowledge transfer training, retain and reward integration staff, and conduct integration audits.

M&A executives cited their top three focus areas for the next integration

15%
a faster pace of integration

14%
a phased approach

14%
a better communication strategy

Organization

Key organizational elements drove integration success according to survey respondents—having a smooth transition, realizing synergies, and meeting expectations and goals. On the flip side, unexpected challenges dominated as the chief reason why an integration failed; almost two-thirds of respondents cited these unforeseen difficulties as the leading factors that foiled a merger. Slow integration or delays in the process and a lack of preparedness— together cited by almost one-in-five respondents—also hindered transactions.

Respondents took the time to handwrite the reasons for success or failure in recent integrations

Most popular reason for success:

49%

Smooth transition

Most popular reason for failure:

63%

Difficult transition/unexpected challenges

Respondents identified several factors as critical in fostering successful integration: having executive leadership support, involving management from both the acquirer and target, and developing an appropriate plan that optimized the use of resources, budget, and timing.

Another key factor in success was assigning a dedicated integration team. A large majority of respondents, 82 percent, created such a team. And an overwhelming majority, 90 percent, said that merger team was pivotal to the successful integration.

Most of the integration teams consisted of more than 10 individuals (63 percent), had cross-functional representation (87 percent), though only 29 percent were dedicated full time to the team. Most companies, 72 percent of respondents, established an executive-lead steering committee; less than half, 46 percent, created an integration management or project management office. A vast majority, 85 percent, of the companies that created either (the steering committee or the IMO or PMO) reported that the creation of the bodies was valuable.

Top three factors cited for achieving successful integration

16% executive leadership support

15% involving management from both sides

14% developing an appropriate integration plan

Operating Model

According to the survey, another factor in facilitating the success of a transaction involved redesigning not only an organizational model—addressing reporting structure and management hierarchy—but also an effective operating model, one that was set to address questions such as where will the company operate, what products will it sell, which customers and segments will it target, and what operations will be outsourced?

About two in three executives said their new organization redesign was effective and 40 percent said it was very effective. Those responses were stronger than the ones ranking the effectiveness of a redesigned operating model. Nearly two in three said their operational redesign was effective and 40 said it was very effective.

The most popular operating models adopted were insourcing and shared services. Direct sales was the most popular commercial model adopted, cited by 58 percent of those companies that said they adopted a new operating model. A majority of companies, 61 percent, said that they considered aligning or simplifying their legal entities in their integration plans.

How effective was the new organizational redesign?

How effective was the new operating model redesign?

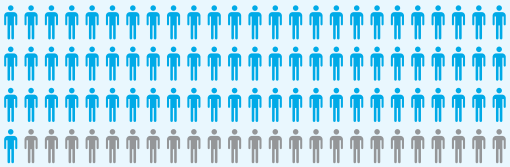
Communication and Culture

Transparent and consistent communication with employees was cited by respondents as one of the top five factors driving a successful integration.

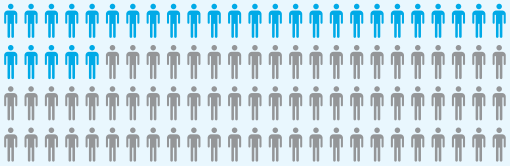
The majority of the executives, 76 percent, said that the alignment of cultures between the two companies was important to the overall success of the integration. And only 30 percent said the alignment of cultures was not effective. Most companies, 61 percent, skirted that potential minefield by ensuring that communications to employees of both combining companies was timely and transparent. More than half, 53 percent, of respondents said that their companies took matters to the next level by interviewing employees from both of the combining companies to determine their needs and concerns.

Company-wide email was the favorite way to communicate the deal, cited by 50 percent of respondents. Other methods included live "town hall" meetings led by the CEO, press release, and managers informing direct reports. Of all those communication forms, the town hall meeting was perceived to be the most effective.

Overall, a majority of respondents, 68 percent, had an employee communications strategy during the integration process. Among those, some 79 percent, said their strategy was effective.



76% said that cultural alignment is **important**



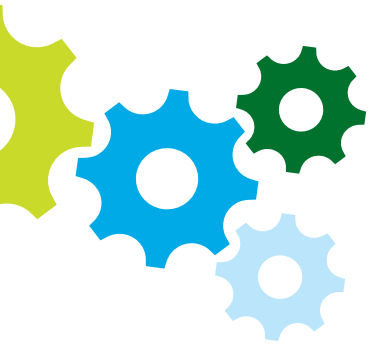
30% said cultural alignment was **not effective**

Most popular communication technique

50%
said company-wide email communications

Most effective communication technique

36%
said live "town hall" meeting led by the CEO



Our Take

Once a transaction closes and a combination has been forged, companies have a critical window of time to get the most out of the merger or acquisition. Being ready at that juncture, at the close, provides a great platform for integration success. In all, there are five focus areas for companies to consider.

Synergy—Maximizing value capture

Successful mergers should start with a clear understanding of the synergies they aspire to capture. Cost reductions typically are a factor, but cost reductions alone shouldn't be confused with synergies—which are motivated by a vision of how the combined company will be able to increase revenues and gain market share at a more rapid clip than either company could alone. The goal of capturing synergies is to create value—improve operating margins, enhance the balance sheet, and provide shareholder value.

Yet, almost 18 percent of survey respondents reported that their merger fell short of their initial synergy targets, and perhaps worse, 10 percent weren't sure if they achieved their goals. We have seen several steps that companies have taken to successfully integrate acquisitions and mine synergies.

First, for a quick source of value, a way to immediately begin mining synergies is for companies to focus on Selling, General and Administrative (SG&A) expenses. This might entail the tough task of eliminating duplicative jobs. Next, companies can turn to procurement, both for direct and indirect spending. Comparing supply contracts and negotiating new prices is low-hanging fruit relative to rationalizing infrastructure (such as consolidating plants). Finally, longer term, companies can focus on growth synergies and the supply chain.

Three steps can help smooth the process:

- **Planning.** Speed, of course is critical, but shouldn't be the predominant driver. Many companies tend to focus on short-term financial synergies rather than take a holistic view. By reducing scope, they often overlook hidden synergies and fail to create high-performing supply chains.
- **Preparation.** During due diligence, companies overlook business and operational compatibility. Operational synergies are not synchronized with the customer/market needs of the combined entities—requiring supply chain rework or savings erosion.
- **Execution.** Many companies drastically underestimate the complexity, resources, communication, and management focus needed to successfully integrate and realize expected synergies.

Overall, companies can get ahead of the curve and accelerate integration and capture synergies. One clear advantage we have seen is in companies that have established a detailed integration plan in advance of the merger closing. That might seem impossible especially since mergers of firms that compete in the same markets might not want to share confidential information about their business practices—or might face antitrust restrictions that prohibit sharing such information. This can make it difficult or impossible to develop integration plans until regulatory approval has been secured.

Creating a "clean team" can help companies clear that hurdle. Clean teams are comprised of employees from both organizations who share confidential information. They are usually small and are lifted from their daily duties to set pro-forma integration plans in place so they can be acted upon once the merger closes.

- A big chunk of planned synergy savings and integration costs often depends on well-executed IT systems integration. Our experience working with many IT integrations demonstrates the value of following a standardized, repeatable approach to post-merger systems integration. Even within a structured integration model, companies can and must tailor the integration to the goals of the deal—such as revenue synergies.

- Some, though, want to create an IT environment that introduces new leading-edge IT systems. These transformative integrations require more customization and learning than a typical integration. The way to proceed here is to first get a full inventory of IT assets before developing blueprints. And then develop a flexible integration framework that includes contingencies.

Readiness—Preparation for post-merger success

One of the main reasons M&A transactions fail is poor preparation for the critical post-merger period. Negotiators place big efforts into closing the transaction —the all-important "win" in complex negotiations—but training for bumps after the deal helps determine whether integration teams truly have the proper gear for bad weather.

Negotiators place big efforts into closing the transaction—the all-important "win" in complex negotiations—but training for bumps after the deal determines whether integration teams truly have the proper gear for bad weather.

In post-merger scenarios, the parties bring different operational, cultural and organizational differences that managers must be prepared to affront. To make sure teams are ready for potential storms, here are some goals that should form part of merger readiness plans:

- Survey employees across departments in the newly merged organization on change readiness and share the data in clear, easy-to-consume formats.
- Be ready to provide mentoring, coaching, and training to team members with leadership potential, regardless of their previous roles, to demonstrate a culture of open-mindedness and employee support.
- As employees, treat every interaction with management as a one-shot deal. There will be gaps in information. Use your best judgment, institutional experience and other cues from the organization to inform your choices. Document your decisions.

Due diligence: pathways to readiness

Our general assumption is that firms making acquisitions conduct thorough due diligence prior to closing a merger deal. This process includes understanding how the target company is valued as well as figuring out how business results are measured. An effective due diligence program will likely catch most—hopefully all—legal and regulatory requirements applicable to the newly merged entity. But nonetheless, there still might be surprises, expenses, or liabilities that were not uncovered or overlooked during due diligence. This is of particular importance to firms looking at targets beyond their industries that have reporting, disclosure, or licensing requirements that differ from their own companies.

On the human capital side, HR M&A teams can gear up for smoother integration if they coach new HR representatives on rules and procedures required for the new entity and prepare them to keep vigilant watch for the unexpected surprises mentioned above. Consider the myriad functions of HR teams—payroll, compensation, benefits, and recruitment, to name a few. Prevailing legal practices in previously independent organizations may be inappropriate or perhaps unlawful in a newly merged entity, underscoring the need for due diligence among HR teams.

No detail too small: leveraging knowledge across calendars and procedures

Another action that companies should take to facilitate readiness is adhering to common calendars. Rudimentary as it may sound, having calendars in sync following a merger will aid PMI by allowing teams to work in concert and avoid inefficiencies.

From Day One, leaders should also be out talking to people at all levels in order to learn the day-to-day operations of the business. This can help them decide which actions are working and which ones need to be retooled. Leaders must learn as much as they possibly can about their new organizations, having candid conversations with employees at all levels.

After having devoted significant time and resources to negotiating the deal, it's easy to overlook the procedures that keep a business running once the merger is complete. But these are precisely the types of details that need to be attended to. In an integration period, managers must have mechanisms in place that support the functions of the business and the human capital responsible for carrying out those functions.

Companies also must assess the readiness of the IT function. By fully evaluating the new IT environment that will emerge in the PMI period, the new entity can make adjustments to systems and teams for this crucial function.

Our experience also shows that merged companies can stumble on risks arising from mismatched organizational structures and processes.

Integration Organization—strategy, preparation, and program structure

On the surface, integration organization might not appear to be a difficult endeavor when it comes to mergers and acquisitions. Almost three-in-four respondents said they have a formal integration strategy and even more assigned a special team to lead the process.

But some companies still struggle with organizational issues. One issue can be that the strategy and preparation phases aren't as robust as the company initially thought it was. In part that could stem back to the due diligence process, particularly in buying start-ups or carve-outs, as data to validate and project performance often are unavailable due to missing operational history.

Sometimes, merging companies might overlook the complexity of post-merger integration issues and not be as prepared to handle the merger as they planned. Realizing tax advantages, for example, may be less complex than realizing cross-selling synergy across the entire value chain. Other issues often overlooked in the planning phase include important steps such as employee training, aligning of incentives and involving line management in decision making.

Our experience also shows that merged companies can stumble on risks arising from mismatched organizational structures and processes. Structural incompatibility may arise from companies that have conflicting degrees of centralized decision making. Core processes can diverge in market orientations in regards to products, customers and sales regions.

People risks represent another category of potential hurdle and exist at all levels, not just the factory floor or worker level. We've seen strong resistance throughout organizations including senior management—probably because the newly merged company won't retain two marketing chiefs, or heads of human resources, etc.

Finally, there are project risks that include not having a formal project organization. Most companies lack the internal resources to run a smooth post-merger integration—which require specific skills.

We see a pattern of success with companies that prepared for mergers by readying management and setting up a post-integration leadership team consisting of cross-functional members. Clear leadership that takes strong responsibility for the post-merger integration process can give fairly-priced mergers every chance of success.

Steps to improve success

- Determine the soundness of financial data. Is the budget and timeframe sufficient to complete the execution of integration (such as the IT systems)?
- Map out synergy goals. Determine the scope of the synergy targets and can they be delivered without disrupting day-to-day business.
- Ensure the integration plan is thorough. Does the plan embrace employee training, harmonizing incentives and other often overlooked yet important aspects?
- Analyze corporate structures. Is there a defined decision making process and who is in charge?
- Mesh core processes. Ensure that market development, order processing, production of goods and outsourcing protocols don't diverge or conflict.
- Create a management team. Determine who is in charge and name names. If adequate integration skills aren't available internally, engage external experts with the requisite experience and skills.

Operating Model—designing the right structure

Operating models can have a tremendous impact on performance and competitiveness, so it's important to get it right, especially when combining disparate companies through a merger.

One of the critical issues is in defining what an operating model is because they often are confused with business models. Business models boil down to "how do we make money?" while operating models describe how the business model will be implemented. Operating models answer critical questions—Where will the company operate? What products will it sell? Which customers and segment will it target? What operations will be outsourced?

Operating models are aligned with detailed tactical capabilities (processes, systems and organization structure) but also answer the broader questions and without delving into granular, day-to-day details.

Businesses face a dichotomy if they need to forge an operating model after combining two companies. They can restructure because of a major event (such as a merger) to avoid the pitfalls that can hinder performance. Or they can restructure in hope of improving overall performance. These require different approaches.

With an event-driven acquisition, time is of the essence in establishing an operating model. Companies need to act swiftly and make some immediate decisions, even if they are not perfect—sitting idle is a mistake. Any adjustments can be made over time. Control of the operating model tends to be top-down and directive. Communication can be delivered directly to those impacted and doesn't need to be broadly disseminated.

The following steps can help in building an operating model:

- Create a small, elite team of experienced people to drive operating model design. Larger groups will slow the process of creating results.
- Document the model with rigor. Create clear and well-articulated directives.
- Embrace imperfection. Think of the design process as an iterative one which can take between six months or a year to develop fully.
- Don't ignore customers. Contact all buyers and clients, even if they're not directly impacted by the merger.

With performance-driven events, companies can act on their own terms and be more deliberate and thoughtful. They can carefully analyze the situation, weigh costs and tradeoffs, pilot a variety of options, and build consensus. Here are some steps companies can take to establish a performance-driven operating model:

- Take a more holistic view and consider outside alliances and partnerships.
- Communicate far and wide. Get everyone in organization able to understand and articulate how the model works.
- Formally document the operating model before initiating its design.
- Reach out to customers and gather their input into developing a model.

The adoption of an ERP system to serve in the post-merger scenario provides a good example of the importance of figuring out the steps in a performance-driven operating model. The Integration team first needs to put a plan in place to launch the system, then execute against that plan. If the ERP system is not meeting organizational needs, the team needs to recast the plan. As timeframes can be tight and there's no room for surprises, companies might consider bringing in consultants to facilitate that the plan will work.

There are specific considerations for creating operating models in mergers with companies in emerging markets. Those might include focusing on product development, for one, in localizing products or tailoring products to a customer base that is less affluent and/or less sophisticated. Another facet might include addressing product supply—infrastructure bottlenecks and supply chain logistics in new markets—as well as distribution, customer education, and market access issues.

With performance-driven events, companies can act on their own terms and be more deliberate and thoughtful.

Communication & Culture—It's all about the people

Frequently in mergers and acquisitions, rumors can begin to supplant the facts. At the acquisition target, specifics are scarce—employees may fear big changes to company culture. Among customers, doubts may surface about familiar products and the teams that produce them: "Will they take on new identities after the match?" Shareholders, vendors and other stakeholders wonder: "Will I receive the same level of service?"

As companies merge forces, clear communication can increase the value of the transaction. When managers clearly define the rationale behind the union, are transparent with teams throughout the integration period and anticipate uncertainties their customers are likely to raise, the narrative is much more likely to be positive.

One of the key actions in a post-merger scenario is a well-rehearsed communications plan. And to ensure that the plan is complete: reaching both internal and external stakeholders.

Starting on Day One, and continuing throughout the weeks and months that follow the deal, companies can log early victories with employees, customers, suppliers and other stakeholders by following the rules in a comprehensive communications playbook.

As an introduction, managers need to tackle the needs of their human capital in the post-merger period. Early and consistent communication to team members should make it clear they were chosen because of their value to the organization. Our experience tells us that managers must share a vision for the goals of the transaction as well as the future of the organization. And naturally, management must include clear expectations of the contributions from everyone on the team.

As tasks are assigned and the day-to-day responsibilities in the post-merger period become clear, some of the most difficult work begins: Perhaps now more than any other period is when communications planning is put to the test as management works to reduce anxieties and win over skeptics.

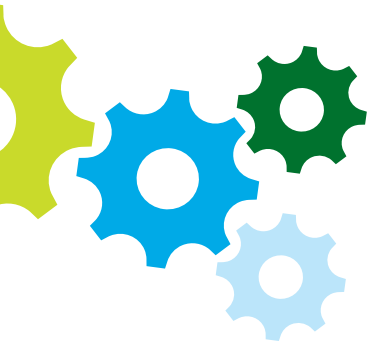
Doubts can surface about the future of the organization and the fate of the people who are charged with keeping the parts moving. Managers have to address tough questions, such as concerns about reductions in force. But they should also look for opportunities in the post-merger period to communicate wins and recognize teams who've made achievements, no matter how small. All of these actions serve to help maintain visibility and build trust in this vulnerable period.

The playbook on communications will not be complete if it does not address customers and other stakeholders who are vital to the success of post-merger integration.

To reassure customers, stem flight and build stronger relationships with stakeholders in the integration phase, communications actions should include the following:

- Identify the audiences that will be affected by the merger, and understand their expectations for good service in spite of the upheaval can surface during a merger process.
- Make a list of must-have communications objectives, to include the metrics that will indicate success of the plan.
- Assign a dedicated team to oversee communications to customers.
- Disseminate the message through channels that are most likely to reach the audience.
- Conduct regular evaluation of the communications plan.
- Don't forget to reach all audiences—external and internal. Focusing on one group alone is missing a big opportunity with another.

When managers clearly define the rationale behind the union, are transparent with teams throughout the integration period and anticipate uncertainties their customers are likely to raise, the narrative is much more likely to be positive.



Conclusion

Some mergers fall short of delivering anticipated benefits, while others may fail spectacularly. But with an understanding of the leading practices for success, companies can navigate the organizational, cultural and operational issues that emerge in the post-merger phase in order achieve the goals of the transaction.

In the upcoming months, we will begin surveying executives to gauge their expectations for merger and acquisition activity. Look for those results and analysis in our next M&A Trends report. After its recent torrid pace, it's possible that the appetite for deals could abate, but a variety of factors—low interest rates, strong cash balances, the desire to enter new markets or product lines, the quest to save costs, among them—likely won't halt M&A activity.

While looking for targets, companies need to evaluate what has made past deals work and what has caused almost one-third of recent deals to fall short of meeting expectations. An analysis of the drivers of deal success shows that having a focused strategy, utilizing the best due diligence techniques and then executing a well-planned integration can help companies maximize transaction value. Companies can succeed if they capture value through synergies, integrate the organizations smoothly, create unified operating models, and communicate effectively both internally and externally.

"It's a strong challenge to get all of those elements done correctly," said Tom McGee. "But it's far from insurmountable—and effective integration planning and thoughtful execution led by a knowledgeable team are key to M&A deal success."

Appendix

Note: some percentages in the charts throughout this report may not add to 100% due to rounding, or for questions where survey participants had the option to choose multiple responses.

Acknowledgment
We would like to thank all survey respondents and interviewees for their time and the insights they shared for this report, *Deloitte Integration Report 2015*.

Survey responses

What were the total approximate annual revenues of your company in 2013?

Less than $100 million
12.7%

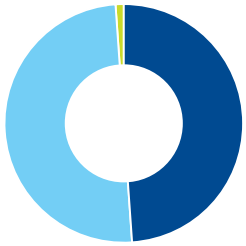
$100 million to less than $500 million
24.7%

$500 million to less than $1 billion
16.9%

$1 billion to less than $5 billion
22.8%

$5 billion or more
22.9%

Is your company public or privately-held?



Public company: **48.9%**

Privately-held: **49.9%**

Other (please specify:): **1.1%**

What was the primary industry of this company?

Alternative energy
1.0%

Construction
4.5%

Financial Services–Asset Management/Private Equity
2.0%

Financial Services–Banking & Securities
5.7%

Financial Services–Insurance
3.0%

Financial Services–Other
1.7%

Health Care Providers & Plans
6.1%

Life Sciences
3.7%

Manufacturing–Aerospace & Defense
2.5%

Manufacturing–Automotive
2.1%

Manufacturing–Consumer Products
8.5%

Manufacturing–Process & Industrial Products
6.1%

Manufacturing–Other
4.7%

Media & Entertainment
2.7%

Energy–Oil & Gas
2.4%

Energy–Power & Utilities
1.5%

Professional Services
8.1%

Real Estate
2.4%

Resources & Mining
0.4%

Retail & Distribution
6.4%

Technology
11.2%

Telecommunications
3.1%

Travel, Hospitality & Leisure
3.1%

Other
7.1%

What type of company was acquired or did your company merge with?

a U.S. multinational
22.8%

a foreign multinational
10.1%

a U.S. domestic company
59.5%

a U.S. subsidiary of a foreign company
1.7%

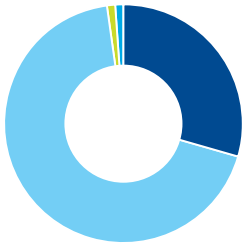
a subsidiary located outside of the U.S. owned by a U.S. Company
1.9%

a subsidiary located outside of the U.S. owned by a foreign company
1.5%

Other (please specify:)
1.0%

Don't know/Not sure
1.5%

Was this company publicly or privately owned?



Publicly owned: **29.1%**

Privately owned: **67.5%**

Other (please specify:): **1.3%**

Don't know/Not sure: **2.1%**

How much did the most recent merger or acquisition you were involved in cost? That is, how much was the deal worth?

Less than $1 million
8.8%

$1 million to $99.9 million
29.9%

$100 million to $249.9 million
16.9%

$250 million to $499.9 million
10.7%

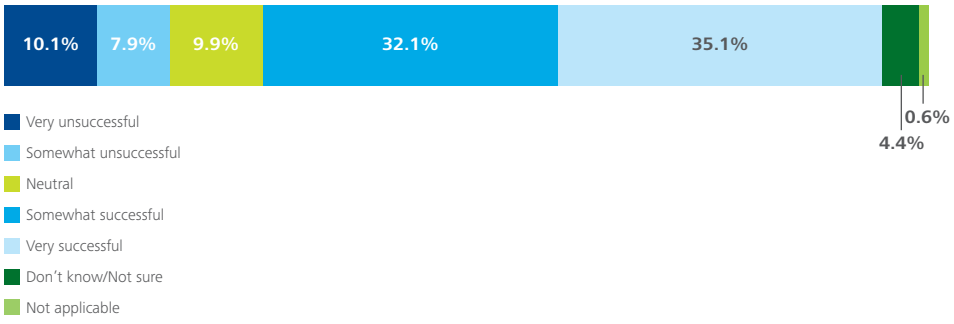
$500 million to $999.9 million
12.0%

$1 billion to $5 billion
10.7%

More than $5 billion
5.9%

Don't know/Not sure
5.1%

How successful do you feel the integration was or has been to date (if your company is still in the integration phase)?



In thinking about the factors that are most important in terms of achieving a successful integration, from among the factors listed below, please rank your top three in order of importance.

	Most important	Second most important	Third most important
Having executive leadership support	**16.3%**	**10.8%**	**6.6%**
Involving management from both sides (the acquirer and acquiree)	**14.6%**	**15.1%**	**13.8%**
Developing an appropriate project plan, optimizing the use of resources, budget and timing	**13.8%**	**11.5%**	**15.1%**
Assigning a dedicated integration team	**12.6%**	**14.4%**	**10.5%**
Communicating transparently and consistently with employees	**10.2%**	**14.8%**	**14.8%**
Achieving or exceeding synergy targets	**9.7%**	**8.0%**	**5.7%**
Assessing and addressing the cultural fit between the two organizations	**9.1%**	**8.8%**	**12.6%**
Allocating an adequate budget for the integration	**5.4%**	**7.8%**	**9.1%**
Establishing a governance structure with a Steering committee and/or IMO (Integration Management Office)	**4.2%**	**6.0%**	**6.4%**
Hiring an external firm to assist with integration	**3.9%**	**2.4%**	**4.0%**
Other (please specify:)	**0.2%**	**0.0%**	**0.1%**

If successful, why do you feel this way?

Smooth Transition **49.4%**

Realized Synergies **16.7%**

Met Expectations/Goals **14.8%**

Improved Financial Position **11.4%**

Well Prepared/Effective Management Team **8.0%**

Timely Integration/On Schedule **4.3%**

Minimal Changes to Organizations **2.5%**

Retained Key Staff/Resources **0.9%**

If not successful, why do you feel this way?

Difficult Transition/Unexpected Challenges **62.5%**

Slow Integration/Delays **12.5%**

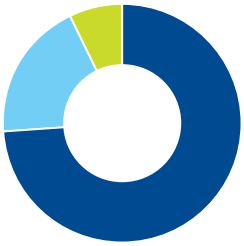
Not Well Prepared/Ineffective Management Team **10.9%**

Worsened Financial Position **9.4%**

Did Not Meet Expectations/Goals **9.4%**

Poor Resource Management/Redundancies **1.6%**

Was there a formal integration strategy?



Yes: **74.1%**

No: **19.1%**

Don't know/Not sure: **6.9%**

How clearly was the integration strategy aligned with the overall strategy and goals of the deal?

Not at all aligned

Somewhat unaligned

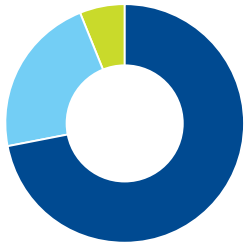
Neutral (neither aligned nor unaligned)

Somewhat aligned

Very aligned

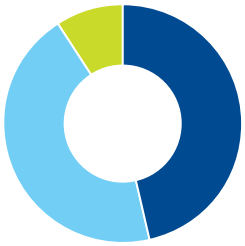
Don't know/Not sure

Was an executive-led Steering Committee established to lead the integration process?



- Yes: **71.9%**
- No: **21.7%**
- Don't know/Not sure: **6.5%**

Was an IMO (Integration Management Office) or PMO (Project Management Office) established?

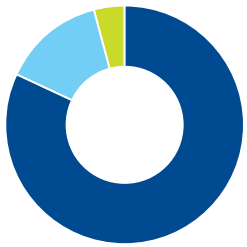


- Yes: **46.2%**
- No: **44.3%**
- Don't know/Not sure: **9.5%**

How valuable was the IMO or PMO to the overall success of the integration?

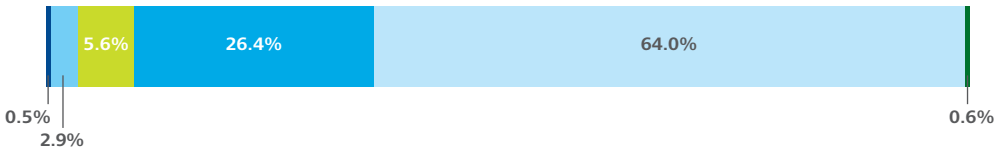
- Not at all valuable
- Somewhat not valuable
- Neutral (neither valuable nor not valuable)
- Somewhat valuable
- Very valuable
- Don't know/Not sure

Was an integration team assigned to lead the integration process?



- Yes: **81.9%**
- No: **13.7%**
- Don't know/Not sure: **4.4%**

How valuable was the integration team to the overall success of the integration?



- Not at all valuable
- Somewhat not valuable
- Neutral (neither valuable nor not valuable)
- Somewhat valuable
- Very valuable
- Don't know/Not sure

Please indicate the size of your integration team.

More than 20 people **22.5%**

16–20 people **19.5%**

11–15 people **21.9%**

5–10 people **23.6%**

Less than 5 people **9.7%**

Don't know/Not sure **2.9%**

Were the people on the integration team dedicated to the integration process or were they also required to continue their normal organizational roles?

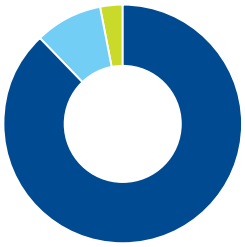
They were dedicated full-time: **28.6%**

Some were dedicated and others were not: **36.3%**

They had dual roles: dedicated to the integration and normal roles: **35.0%**

Don't know/Not sure: **0.2%**

Did this integration team include cross-functional representation?



Yes: **87.4%**

No: **9.4%**

Don't know/Not sure: **3.2%**

How effective was the new organizational redesign?

Very ineffective

Somewhat ineffective

Neutral (neither effective nor ineffective)

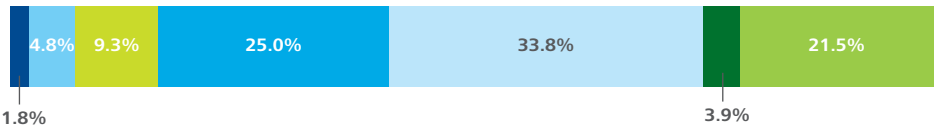
Somewhat effective

Very effective

Don't know/Not sure

Not applicable

If the integration strategy involved a redesign of the combined company's operating model, how effective was this operating model redesign with the main goals of the deal?



Very ineffective

Somewhat ineffective

Neutral (neither effective nor ineffective)

Somewhat effective

Very effective

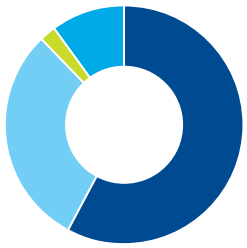
Don't know/Not sure

Not applicable

Thinking again of the redesign of the combined company's operating model, for each of the following functions, which operating model was adopted?

	Insourcing	Outsourcing	Shared services	Other (please specify:)	Don't know/Not sure	No change
Finance/Accounting	**40.9%**	**9.1%**	**31.8%**	**0.0%**	**1.4%**	**16.6%**
Human Resources	**40.4%**	**13.0%**	**29.3%**	**0.0%**	**1.0%**	**16.3%**
Information Technology (IT)	**35.8%**	**16.1%**	**31.7%**	**0.0%**	**1.5%**	**14.9%**
Legal	**28.8%**	**23.6%**	**27.4%**	**0.0%**	**3.3%**	**17.0%**
Manufacturing	**32.0%**	**15.8%**	**24.3%**	**0.0%**	**4.6%**	**23.3%**
Sales and Marketing	**38.5%**	**13.5%**	**28.6%**	**0.0%**	**2.2%**	**17.1%**
Tax	**33.9%**	**16.3%**	**27.6%**	**0.0%**	**4.1%**	**18.2%**
Operations/Supply Chain	**35.1%**	**13.4%**	**32.5%**	**0.0%**	**2.1%**	**17.0%**

Which go-to-market or commercial operating model was adopted?



- Direct sales: **57.7%**
- Distributors: **30.5%**
- Other (please specify:): **2.2%**
- Don't know/Not sure: **9.6%**

Did you consider legal entity alignment or simplification in your integration plan?

- Yes: **61.4%**
- No: **23.4%**
- Don't know/Not sure: **15.2%**

Did you factor tax planning into your synergy capture plans?

- Yes: **55.6%**
- No: **29.9%**
- Don't know/Not sure: **14.5%**

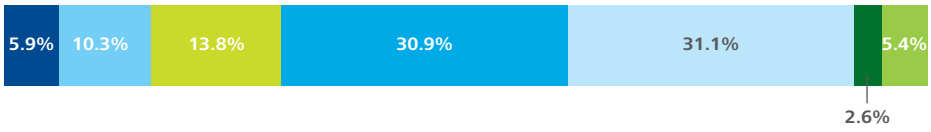
How important was the alignment of cultures between the two companies to the overall success of the integration?

- Not at all important
- Somewhat not important
- Neutral (neither important nor not important)
- Somewhat important
- Very important
- Don't know/Not sure

How was the alignment of cultures managed? (please select all that apply)

- Communications to employees from both companies were timely and transparent **60.7%**
- Employees from both companies were interviewed during the integration process to understand their needs and concern **52.9%**
- Traditions from both companies (e.g. Holiday parties, perks, etc.) were honored **45.0%**
- Other (please specify:) **3.2%**
- Don't know/Not sure **7.6%**

How effective was the alignment of cultures?



- Very ineffective
- Somewhat ineffective
- Neutral (neither effective nor ineffective)
- Somewhat effective
- Very effective
- Don't know/Not sure
- Not applicable

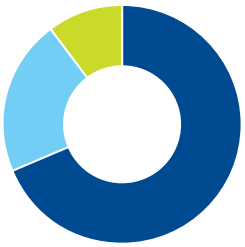
How was the deal announced to employees? (please select all that apply)

- Company-wide email communication **50.2%**
- Live ''Town hall'' meeting lead by the CEO **36.4%**
- Press release **35.6%**
- Each manager informed his or her direct reports **32.9%**
- CEO made a speech that was recorded and broadcast **29.9%**
- Intranet or internal social media announcement **26.7%**
- HR made a presentation/HR will make a presentation **25.2%**
- Other (please specify:) **1.4%**
- None—there was no official announcement **1.1%**
- Don't know/Not sure **2.0%**

Which of the following do you feel was the most effective employee communications vehicle for the announcement of the deal?

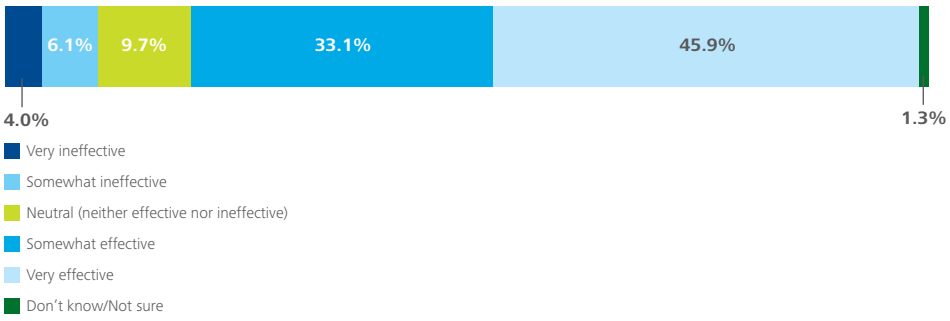
- Live ''Town hall'' meeting lead by the CEO **23.8%**
- Company-wide email communication **21.1%**
- Each manager informed his or her direct reports **17.2%**
- CEO made a speech that was recorded and broadcast **13.6%**
- HR made a presentation/HR will make a presentation **9.9%**
- Press release **7.8%**
- Intranet or internal social media announcement **5.5%**
- Other (please specify:) **1.0%**

During the integration process, was there an employee communications strategy?

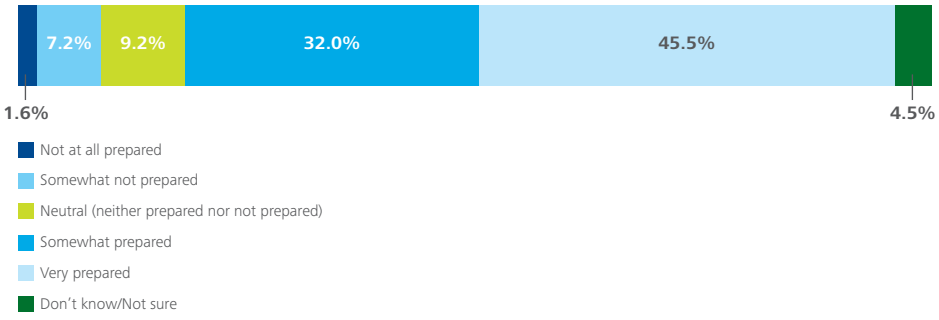


- Yes: **68.5%**
- No: **21.2%**
- Don't know/Not sure: **10.3%**

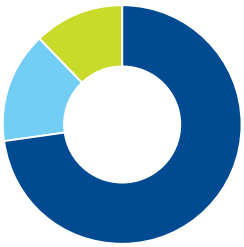
How effective was the employee communications strategy during the integration process?



How prepared do you feel your organization was on the final day of the integration phase?

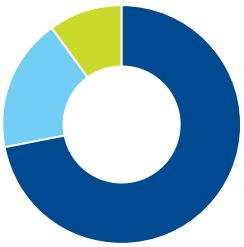


Was the success of the deal evaluated after integration?



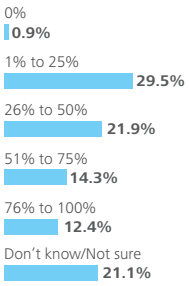
Yes: **72.9%**
No: **15.3%**
Don't know/Not sure: **11.8%**

Were there detailed execution plans in place that were put into action on the day the deal legally closed and the new organization became operational?

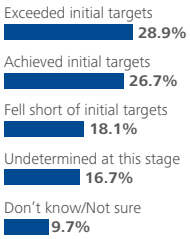


Yes: **72.0%**
No: **18.4%**
Don't know/Not sure: **9.6%**

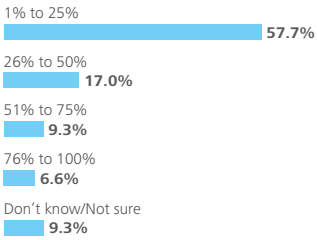
As a proportion of the total deal value, what do you estimate was the total benefit from synergies?



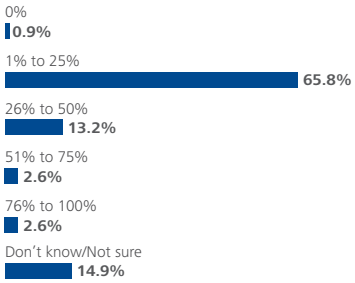
Were the initial synergy targets achieved, exceeded or did they fall short?



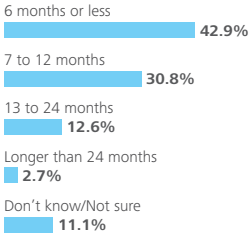
By what % were the initial synergy targets exceeded?



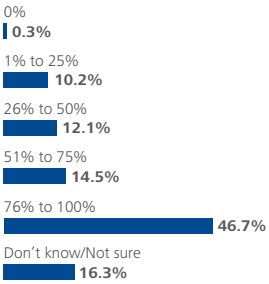
By what % did they fall short of the initial synergy targets?



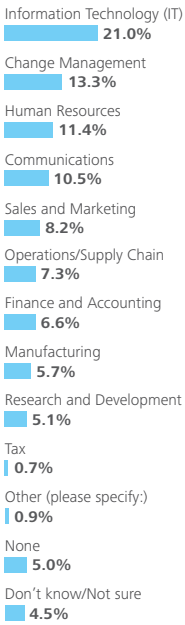
How long did it take to realize these synergy targets?



What % of key staff from both organizations was retained following the integration process?



In which functional area do you see the biggest need for improvement in terms of integration skills/capabilities in the future?



Which steps did your company take to internalize the lessons learned from the integration experience?

Assuming you were to do another deal in the future, please rank, in order of importance, the three areas you would focus more on the next time.

	Most important	Second most important	Third most important
A faster pace of integration	**14.6%**	**5.7%**	**6.3%**
A phased approach to integration	**13.8%**	**13.6%**	**8.9%**
Better communication strategy with employees	**13.6%**	**14.6%**	**11.2%**
More rigorous selection of the right integration manager/team	**11.1%**	**7.4%**	**9.5%**
Larger budget for integration	**10.9%**	**11.1%**	**7.0%**
Better change management program	**10.2%**	**14.0%**	**13.0%**
Better communication strategy with customers	**6.7%**	**9.3%**	**7.0%**
More focus on cultural fit or better cultural alignment	**5.1%**	**6.0%**	**11.7%**
More planning ahead of the deal's announcement	**5.0%**	**5.5%**	**9.3%**
More planning for the "go live" date—the day the deal closed and the new organization became operational	**4.1%**	**5.1%**	**6.0%**
Better communications strategy with suppliers/distributors/partners	**3.4%**	**5.7%**	**6.9%**
Other (please specify:)	**1.6%**	**0.1%**	**0.3%**